United States Court of Appeals

for the Second Circuit

JOINT APPENDIX

76-7278

Volume A-7
Page A-211(2190) to A-211(2595)

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 76-7278

B

MARGARET MARY MCDONNELL MURPHY, *Plaintiff-Appellant,*

against

MCDONNELL & CO., INCORPORATED and THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, President, *Defendants.*

JAMES F. MCDONNELL, JR., individually, as Trustee under the Will of James F. McDonnell and as Executor of the Estate of Anna M. McDonnell, and CHARLES E. MCDONNELL, as Executor of the Estate of Anna M. McDonnell, *Plaintiff-Appellants,*

against

THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, THE NEW YORK STOCK EXCHANGE, INC., THE AMERICAN STOCK EXCHANGE by H. VERNON LEE, JR., Secretary, and MCDONNELL & CO., INC., *Defendants.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

JOINT APPENDIX (Vol. A-7)

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MARGARET MARY MC DONNELL MURPHY, et al.

vs.

71 Civ 461
71 Civ 1940

MC DONNELL & CO., INC., et al.

May 19, 1975
10:00 a.m.

Trial resumed.

- - -

(In open court; jury not present)

THE COURT: Yes, sir.

MR. BROOKS: Your Honor, over the weekend we were busy trying to research a subpoena which Mr. Beebe had served on us. We have found all documents that we have responsive to that subpoena. I have no problem turning over any document that relates to McDonnell & Company, but there are some documents which were described in the subpoena which constitute either letters between exchange officials and commissioners of the Securities and Exchange Commission, or in one case what I guess is at

best described as minutes of a meeting held at the Securities and Exchange Commission between the commissioners and the SEC staff and the top staff of the stock exchange on December 11, 1969.

Now, these documents in no way mention McDonnell & Company or are related to them.

So to the extent the subpoena would compel us to turn these over to the plaintiffs, we object and move to quash the subpoena on the grounds of relevancy and the fact that such documents in the understanding of the exchange are ordinarily supposed to be maintained in confidence.

I will be glad to submit them to your Honor for you to review.

MR. BEEBE: I haven't seen these.

MR. BROOKS: I am not going to show them to you until I get a ruling, Mr. Beebe.

One is a set of minutes for December 11, 1969, a meeting. The other is a letter from the chairman of the SEC, President Haack of the exchange, dated December 9, 1968.

MR. BEEBE: May I be heard for a moment, sir, to put this in context?

The questioning of Mr. Bishop this morning

is going to involve, among other things, meetings that he attended and statements that were made in his presence at the SEC concerning the very basic involved in this case, enforcement of the net capital rule by the New York Stock Exchange in 1968 and 1969.

As your Honor knows from the testimony so far, there is a serious question that we have already raised and an issue joined on whether or not the stock exchange applied normal application of the rules in its enforcement during that period.

We also know that there are only three companies they singled out in their later explanation of what they did and one of them was McDonnell. So the fact that a particular memo or letter or meeting does not name McDonnell & Company per se is not at all a reason for having that document be inadmissible, since their activities at the exchange at that time on the very subject of enforcement are at issue here.

Also about the particular meetings I could point out particular documentation that we already have indicating that Mr. Bishop was the man who attended these meetings and what it is he said or didn't say, which is why we subpoenaed these documents, because Mr. Bishop, we find, does not have a very good memory when he

doesn't have a document in front of him.

THE COURT: The only way I would see a document such as this could be used would be if there were some admission against interest of the New York Stock Exchange.

MR. BEEBE: I'm afraid I don't know which particular one you are referring to.

THE COURT: I have a memorandum of a December 11 meeting between the SEC commissioners, certain exchange personnel, certain SEC staff and others, and some secretary has a shorthand dialogue of what the various people are saying.

It would seem to me that that memorandum, unless it contains some admission against interest of the stock exchange, is not usable by you in any fashion.

MR. BEEBE: Could I ask that Mr. Bishop adjourn for a short minute so I can read you what it is that we have that he's reported having said at that meeting?

THE COURT: This is December 11th?

MR. BEEBE: Yes.

THE COURT: Go ahead.

MR. BEEBE: I would appreciate if Mr. Bishop

was not here.

THE COURT: Mr. Bishop, would you step out to the hall during this colloquy, please.

(Mr. Bishop leaves)

MR. BEEBE: We premarked as Exhibit 102 for identification the case study conducted by the -- under the orders of the Senate subcommittee on banking and housing. At page 231 of that study it is stated:

"For example, on December 11, the staff reported that an exchange officer speaking for him and not the board of governors had confided as follows: 'He stated that the stock exchange staff was under great pressure to interpret the rule as loosely as possible so that firms would not be deemed in violation of the rule. He further stated that once public ownership was approved an d put into effect for member firms, the staff would shift their position 180 degrees on the interpretation of the exchange's net capital rule.'"

Now, I plan to ask Mr. Bishop about what he said, since I have from other sources evidence that he was the stock exchange official who made that statement, and I plan to ask, if he doesn't give us any recollection of what he said, if he made a report or if a memo or minutes or any other record was made of that meeting.

THE COURT: Let me look at what you just read.

MR. BEEBE: Yes, your Honor (handing). Page 231, the indented portion.

(Pause)

THE COURT: Mr. Beebe, do you think it's fair, given footnote 7 here on page 231, that a man should have this read to him in the courtroom so that the jury hears it and then has to hear what you know is going to be a denial?

MR. BEEBE: My plan, sir, since I know that he generally denies anything of that nature, is not to do that during any of the testimony I am going to elicit from him. I am going to ask him what he said and what he didn't say. And if he denies saying anything along those lines, I certainly would not read something into evidence, unless it comes in on its own two feet, that is of that nature.

I have carefully planned the questioning to avoid that problem.

THE COURT: Unless this quotation in the securities industry study, part 4, page 231, which has a footnote 7 to it, unless that quotation is adopted by the witness and that witness happens to be Mr. Bishop,

there is no basis to use it. Am I correct?

MR. BEEBE: This witness testified at the Dempsey Tegler trial, and I have the transcript of that testimony, and at page 200 --

THE COURT: Let's see what that is, because I don't see that this printed report --

MR. BEEBE: He was asked about that same printed report which was, by the way, your Honor, introduced in evidence in Dempsey Tegler.

THE COURT: You have a judge sitting without a jury, which makes a lot of difference.

MR. BEEBE: The basis of the introduction, I'm told by Mr. Augustini, who was the attorney, was the government record, that iw as a government record.

MR. BROOKS: Could we have a citation to Dempsey Tegler?

THE COURT: Where in this 103 for identificatio is it?

MR. BEEBE: 2481, the passage reads:

"If member firm's capital could be improved in the way that public ownership would permit, then our staff would turn 180 degrees in wanting to strengthen the capital rules."

It's in the middle of that long passage on

that page.

MR. BROOKS: Your Honor, I have that passage before me.

THE COURT: Let me read it first, please.

(Pause)

MR. BEEBE: It's at the end of that passage.

THE COURT: Correct me if I'm wrong, Mr. Beebe, that Mr. Bishop acknowledges that he is the genesis of this misquotation.

MR. BEEBE: That is his position, sir.

THE COURT: That it came to pass in connection with a proposal that there be public ownership of member firms which,according to the next page, did not become accepted, according to the questioner, until the spring of 1970, whichwas after our events.

MR. BEEBE: My impression is that during --

THE COURT: Wait a minute. It had to do with how Mr. Bishop would feel about wanting to make the capital ratio even smaller. In other words, lower and lower. If you had public ownership of firms rather than the present firm ownership setup. That is what he is talking about. If the firm goes public. Now, I don't know what the situation is here. But if a firm

goes public Mr. Bishop is saying, "I would be for making the capital rules even stronger."

Isn't that what he is saying?

MR. BEEBE: As part of the lobbying effort in 1969 to get the SEC to permit public ownership, which as you point out on the next page, is indicated as having taken place the next year. That's what he is saying. As part of that the exchange was saying to him words to the effect that why aren't you interpreting the rule better, more vigorously, and he stated, words to the effect, as he is quoted in the staff report on page 231, that he was under great pressure to interpret it as loosely as possible because otherwise a lot of people were going to be going over the hill.

I think from the other passages that I am going to be putting in and questions I am going to be asking him where he is quoted earlier to a similar effect and the SEC takes a position to the similar effect, this was a state of affairs that existed throughout 1968 and 1969.

The fact that the SEC caught up with them at the end of '69 and into 1970 and that Congress got around to investigating this and looking back and seeing what happened in 1971 and 1972, does not gainsay the

fact, sir, that all of the things that they were investigating were exactly in the period in question, 1968 and 1969.

THE COURT: But what I gather Mr. Bishpp is saying is that if you have public ownership of member firms you should have a stronger capital rule because you now have public owners to protect in addition to just the customers. The present capital rule is a protection for the customers but is not necessarily protection for the owners. If you get to the position of public ownership you then are going to need protection for the public owners.

Am I right about that?

MR. BEEBE: I really can't agree with that, sir, if I can with all due respect disagree. When he says shift 180 degrees on the interpretation and they were interpreting it as the present --

THE COURT: At this point he said "I don't want to strengthen the capital rules."

If you had public ownership I would turn completely around and I would want to make them stronger.

MR. BEEBE: The obverse is they were not strongly intrepreting at that time. In fact they were loosely interpreting them.

THE COURT: I don't draw that inference from that as something that I would permit a jury to conclude from it. I would not permit a jury to conclude from this statement that they were interpreting these rules loosely. I would interpret that the most the jury can take from this statement is the fact that these rules are not presently strong enough to protect public owners, were there to be public ownership.

MR. BEEBE: Well, when you say "This statement" I gather you are focusing solely on the Dempsey Tegler transcript.

THE COURT: 2481.

MR. BEEBE: I have to admit I was also focusing on the report by the --

THE COURT: But he disavows the report. He says it's a misquotation.

MR. BEEBE: He says it's not accurately reflected. If he disavows the whole thing, then when I ask him that on the stand I am not going to do what you suggested would be in my mind. I have never done that at this trial, to read something to a guy and just have him say no, I didn't say that.

By the way, your Honor, that's exactly why I wanted the minutes of that meeting, to see if there was

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any shred of support for what it says on page 231.

THE COURT: Let me look at the minutes of the meeting and see if they help you.

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THE COURT: Am I correct that McDonnell is not mentioned in this exhibit?

MR. BROOKS: That is correct, your Honor.

MR. BEEBE: The important fact is that they are talking about the industry and McDonnell as one of the major three companies that we have already seen evidence of was subject to this special application or nonapplication of the rules, which is exactly what is the subject of that meeting as it is quoted in both Dempsey and the case study.

THE COURT: I know, but isn't the question here whether given what the rules are or were, and what you contend the facts are, what this jury is going to conclude, and whether in a substantial give and take discussion of trade conditions between the people, which was a typical kind of board meeting where people are trying to get facts and decide as to what might be done, and throwing out suggestions of what may be good, and then five seconds later determined to be worthless - how can that be probatively admissible for this jury?

MR. BEEBE: I think that one of the suggestions is that it says in a case study that they were under pressure to determine the rule loosely, and as kind of justifying what happened they said, look, we can't interpret the rule vigorously because it is going to throw a lot of people

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out of business. "Loosely" is a euphemism or fancy word for saying that they suspended enforcement of the rules.

THE COURT: Let me ask you, Mr. Brooks, is there any problem with his looking at this and before any use is made of it he advises as to what use is proposed, and I will rule on it? I am not prepared to say --

MR. BROOKS: I have no objection to that, your Honor.

THE COURT: All right.

MR. BROOKS: If you should decide it is not suitable for evidence I would like it back.

THE COURT: All right, and we will mark this as a plaintiffs' exhibit for identification.

(Marked Plaintiffs' Exhibit 109 for identification.)

THE COURT: And before any use is made of that exhibit in this trial in any way, Mr. Beebe, you will have to clear it with me.

MR. BEEBE: Yes, sir. I think I have a pretty good track record on that.

THE COURT: Mark this Plaintiffs' Exhibit 110 for identification.

(Marked Plaintiffs' Exhibit 110 for identification.)

THE COURT: Now let me review 110 here while we

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are looking at that and see where we go.

MR. BEEBE: Your Honor, could you tell us at least what 110 is?

THE COURT: 110 is a letter from a Mr. Cohen, chairman of the SEC to Mr. Haack, dated December 9, 1968.

MR. BEEBE: I might draw your Honor's attention to the quoted page at page 228 of the study, which is from that letter, which is - I think I can reveal without --

THE COURT: You have letter already?

MR. BEEBE: I only have that quoted passage, your Honor, which is why I subpoenaed the letter in case I ran into difficulties in getting in the case study, I wouldhave the original letter.

MR. BROOKS: Your Honor, I agree with Mr. Beebe that the quoted passage in the case study is found in the letter along with a lot of other things.

I object, though, to the quoted passage from any source coming into evidence because it is not relevant and not probative and has nothing to do with McDonnell.

MR. BEEBE: I think that is perhaps a serious question.

THE COURT: Let me read it.

Let me ask you two questions in connection with Exhibit 110 for identification. I gather from what you read

in the report that you would like to say to this jury that Mr. Cohen is backing up the exchange on the firm application of the exchange's net capital rules?

MR. BEEBE: Yes. The passage is quoted in Dempsey, and I assume also appears in the letter.

THE COURT: Do you contend that where in late January, early February, 1969, following this letter Mr. Bishop advises McDonnell -- McDonnell is not mentioned here, needless to say -- advises McDonnell that they must get $500,000 in in two days, but that is not under the circumstances construeable as a firm application of the rules?

MR. BEEBE: Oh, I think, sir, you will see--

THE COURT: No, stick to my question, please.

MR. BEEBE: I have said before on that particular question that it was a misapplication of the rules to issue that order without issuing protection at the same time and making sure that the people who were being pulled in knew what was going on. That itself, your Honor, is a misapplication of the rules.

THE COURT: I am not going to let you do it, I don't think, in any event. You see, you have got a single line which you conceivably could argue something from, although it is a matter of opinion at this point and it's a matter of a direction from a superior --

MR. BEEBE: That's correct.

THE COURT: -- which the jury's problems at this point as to whether or not the rules should properly apply in the net capital field, and he says you have got to be firm with the application.

MR. BEEBE: The implication being you are not being firm already.

THE COURT: All right, be that as it may, what they did in February was to say $500,000 within two days, please.

Now, is that inconsistent with that demand?

MR. BEEBE: May I just tell you my answer on that which is not limited to that particular one $2,000,000 in a week --

THE COURT: I appreciate that, but that has nothing to do with this piece of evidence. This piece of evidence only goes to the capital rule.

MR. BEEBE: I am talking about the capital rule, I am talking about the capital rule immediately after our clients took their money in, in February and March and April the company continued the violation; it wasn't corrected, and they did nothing--

THE COURT: As far as the capital rules were concerned?

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MR. BEEBE: Yes, yes, net capital rules. I am not talking about operations; I am talking about net capital, the ratios from the figures we have in evidence.

THE COURT: As I understood it, they were yoyoing around the 2,000 mark all the way through Memorial Day.

MR. BEEBE: Sir, we never tried to lead you to that conclusion, according to the exhibits in this case. The exhibits in this case show way over 2,000 all the time, all the time, and they didn't correct it. And that's why this is so important. I know what I'm saying is exactly the contrary of the assumption that you have been working on, but that is the fact, and I can show you right now an exhibit we have marked for identification --

THE COURT: Is it a fact known to the stock exchange?

MR. BEEBE: Those are all trial exhibits (handing).

THE COURT: Now, you are saying that in the period while everybody is waiting for that Lybrand audit, they, in fact, were in capital violation, but the fact of the matter is they were submitting reports to the exchange through January, the second week in January indicating they were in compliance.

MR. BEEBE: On the right-hand side of that list is the dates on which the exchange received these various

reports.

THE COURT: I appreciate that. In the period around January 31st of 1969 there is no question because that is the time of Mr. Bishop's ultimatum.

MR. BEEBE: The point I am making is that after that date --

THE COURT: Then on April 24th --

MR. BEEBE: Still at 3,500, 65 per cent, according to Exhibit 65, which is their own internal computation.

Where it says Trial Exhibit E-3 underneath, that should be 83.

THE COURT: April 18th? I suppose that's along about the time that Murray McDonnell is required to go out and borrow. So the fact is they go over again, so Murray goes back to the well.

MR. BEEBE: Not according to their -- as you go on, not according to their internal computations.

THE COURT: I don't see that.

MR. BEEBE: On the next page it continues that Exhibit 52 is an estimate, but three days later on Exhibit 23B we are up to 2,920 per cent. And then when you get down to Exhibit EEE, which was their exhibit --

THE COURT: Yes, that is September and the ballgame is over.

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MR. BEEBE: As of July 31st.

THE COURT: I know, but the communication of that is in September.

MR. BEEBE: That's true, sir. All I'm saying is I looked through their exhibits to try and find something where that theory that all this money is coming in was actually solving something and it isn't there. I was as surprised as could be, because I kind of was operating on the same assumption, that the money came in and therefore things were solved and you could shift and focus on the operating. But that's not what happened. The money came in and it wasn't solved. The net capital rule continued to be in violation.

I went back to Mr. Arning's testimony, even given a week or two weeks, but this is the whole time.

THE COURT: At this point I want to give consideration to this Mr. Cohen letter, 110 for identification. I will hang on to this and I will reserve decision on this. My inclination is not to turn it over.

MR. BEEBE: While we are here I believe there are some others.

MR. BROOKS: Yes. On the other subpeonaed documents, your Honor, and also covering the file that Mr. Beebe asked me to have Mr. Bishop's secretary go back and look through, we have documents which we have no objection to producing, although I'm not sure I would not

object when they are offered into evidence, at least some of them.

What we are producing is a draft of Exhibit 86, which Mr. Bishop said he prepareed; a letter to Chairman Budge by John Cunningham dated October 30, 1969; a letter dated November 19, 1969 to Mr. Baruch of the SEC.

I think indeed I may offer some of these myself, but Mr. Beebe would wish to do so.

Otherwise we have found no other documents of the type subpoenaed or requested and that we searched for in our file.

MR. BEEBE: If I can just run thorugh a check list, your Honor, since I have these copies of the documents, he has handed us copies so he is not asking you to make a review at this point.

There were the SEC letters, and these have been produced, I take it?

MR. BROOKS: So far as they exist they have been produced.

MR. BEEBE: Now, another subject, while we are here, is Exhibit 43, 43A and 100. These were marked for identification, and what I am trying to solve is the problem of having to call Mr. Spies or someone back just

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to authenticate them. Here is 43 and 43A, and 100 also.

I will show them to your Honor, and what I would like to do is simply have them offered, unless there is some serious objection about their authenticity. I will explain what they are.

I believe 43 is the letter from Mr. Spies to McDonnell commenting on McDonnell's financial questionnaire of January 30, 1969; 43A is the financial questionnaire itself.

I will stop there for a minute and take 100 separately.

I wrote to Mr. Brooks, in fact I handed those exhibits to him last Thursday and asked him if there was an objection,and I wrote on Friday and memorialized request to just put these on a basis so we wouldn't have ot call Mr. Spies back for these two items.

MR. BROOKS: Mr. Beebe wrote and said he believed he could identify them through the deposition testimony. We looked through the deposition testimony and we find that is not the case. So far no one has identified Exhibit 100 or Exhibit 43, either on the stand here or in deposition testimony.

We have admitted in our answers to demands to admit that both 43 and 100 are in the files of the

exchange. I still maintain the objection to their admissibility here. I don't think there is a proper foundation yet for them.

MR. BEEBE: As I understand it, it's just foundation questions that they are raising, and Mr. Brooks earlier had offered to make people available from the exchange. Of course, Mr. Spies is from the exchange and we could have him called back, if necessary, just for the foundation question. But I think, your Honor, at this late date and this point in time, and especially since when I had foundation objections I always admitted that I really didn't have any problem with authenticity, I think I would just like to put these in. They are very relevant and somewhat important to our case and I am going to pursue it through witnesses if I have to.

MR. BROOKS: On the calling back of Mr. Spies, I object to it. Certainly it would have been proper to ask him on plaintiffs' direct case to look at these exhibits and identify them. Plaintiff didn't do that at the time. I suggest that it's not proper on a rebuttal case to call back a witness to lay a foundation for a document that you had in your hand at the time he was here and which you didn't interrogate on, especially when it's not responsive to the defendants'

case that went in subsequentl .

MR. BEEBE: Your Honor, this is being way overly technical. I also think that I did examine Mr. McElroy on these, on 43 and 43A, and he disclaimed personal knowledge.

When I got to Mr. Spies, well, I have to say there are 100 exhibits in this case. It's this kind of housekeeping that I think is appropriate to be done at this point.

MR. BROOKS: On 43A, your Honor, that was not even a deposition exhibit nor did we admit anything as to it. As far as I'm concerned, no one has identified 43A.

MR. BEEBE: 43 doesn't make any sense, nor does Exhibit 25 for that matter, unless you refer to the financial questionnaire, which is what 43A is. They both refer to financial questionnaires. I can show your Honor an exhibit.

THE COURT: What is involved? Mr. Brooks does have a point, you know. He defends against a certain plaintiffs' case and then all of a sudden when his case is practically finished you come in and want to throw in some other documents,which has an essential unfairness to it.

MR. BEEBE: If it's being done on that narrow ground, of course the answer is that the question was raised as to how much -- and this was on the rebuttal case -- how much Mrs. Murphy and Mrs. McDonnell actually put in. What were the dollar figures. If you will examine, your Honor, 43A you will see that their complete subordinated accounts are set forth right there.

THE COURT: Is that what you are offering that for?

MR. BEEBE: Also for another thing that's very important. They might take the position that what I just argued this morning was wrong, that in the January figures that they were construing, the January 30th figures, did not include our client's account. So that if you take the end of each you say in the end of April, Exhibit 25, their figures show 3000 per cent or 5000 per cent, they could say that doesn't include your client's money.

When your client's money came in that was all involved. That's what exactly what 43A shows, that our client's money was in there on January 30th and were counted by the exchange's own figures.

MR. BROOKS: This shows to the contrary. This is a document obviously prepared by McDonnell &

Company. If you will look at schedule 10, page 1, what it shows about Mrs. Murphy is that they are claiming that her account is in pursuant to an agreement dated January 30, 1969.

We all know in this case Mrs. Murphy's agreement is not dated January 30, it's dated February 4. So it's obvious that it's an error and it couldn't be binding on the exchange. It's for those reasons that I am not going to admit it.

MR. BEEBE: I find that,your Honor, at best amusing because there is no other agreement that she signed or put in. More importantly, their own computations were based on that.

THE COURT: You are trying to charge the exchange with knowledge of something that happened on January 30th.

MR. BEEBE: Their own computations in Exhibit 43, the letter that is the analysis, is an analysis of those figutes. That's exactly what they are analyzing.

THE COURT: Suppose I admit 43A for the purpose of showing what the exchange received without it being proof of any underlying fact?

MR. BROOKS: I didn't even know the exchange

received this document. They may have received one that is correct. This one was obviously incorrect. It says Mrs. Murphy signed an agreement dated January 30 and we know she didn't.

MR. BEEBE: There isn't any agreement they put in so dated as far as I can tell. That exhibit especially setting forth the status of Mrs. McDonnell's account is exactly what they received and they acted upon it. They did it in Exhibit 25 as well. If we called Mr. Spies back he would so testify.

MR. BROOKS: Your Honor, Mr. Beebe got document production both from the exchange files and from McDonnell's files. This could have been a draft in McDonnell's files.

THE COURT: I appreciate that.

MR. BROOKS: Mrs. Murphy's subordination agreement, Exhibit 3 put in by plaintiffs, is dated Februray 4th.

MR. BEEBE: I don't think that is all the point.

THE COURT: The short of it is Mr. Brooks is not going to stipulate to this document going in, so that's the end of it.

MR. BEEBE: I would ask two things, your

Honor, since this is an important document: I would ask Mr. Spies be called back so I can put that one document in through Mr. Spies, and I would ask that if they have a document in their file which is the January 30th answers to financial questionnaire, they bring it and I will be happy to deal with theirs. That would put to bed any question about this document. But it's important, your Honor.

MR. BROOKS: I object to that at this stage of the case, your Honor.

MR. BEEBE: I think really --

THE COURT: This is being offered for the limited purpose of showing Mrs. Murphy's money in this business.

MR. BEEBE: And Mrs. McDonnell's money. The most important purpose, sir, is that the money was counted in when the exchange made its computations later on that chart that I showed you. Those figures, those 3000 and 5000 figures include our client's money. That's the vital point.

THE COURT: Mr. Brooks, suppose you were to stipulate to 43, which is Mr. Spies' letter, it includes a certain amount of "net capital" on its face, 3 million 9, and that that 3 million 9 includes Mrs.Murphy's and

Anna McDonnell's money.

MR. BROOKS: I don't stipulate to that, your Honor. I don't see in Exhibit 43 that it says it includes Anna McDonnell's money and Mrs. Murphy's money.

THE COURT: Suppose you waive the argument that it doesn't.

MR. BROOKS: I waive that argument?

THE COURT: Mr. Beebe doesn't want to argue it. He just doesn't wantyou to be able to argue it to the contrary.

MR. BROOKS: No, your Honor.

THE COURT: All right. Then I think we had better bring Mr. Spies back.

MR. BEEBE: And also their copy of that one document, that is the January 30th response to the financial quesionnaire. That's all.

THE COURT: Just for that one limited purpose?

MR. BEEBE: Of laying the foundation. The letter, the SOQ, andswer to the financial questionnaire of January 30th. I think I have already given them a copy of it.

THE COURT: I don't frankly understand what all this is about here.

MR. BROOKS: When does plaintiff plan to do this? We have Mr. Bishop on the stand now.

MR. BEEBE: First witness on our rebuttal case. It will take five minutes.

MR. BROOKS: All right.

MR. BEEBE: Is there anything else?

One last thing, your Honor. I will be asking Mr. Bishop about some other meetings that I subpoenaed notes for. There was one on April 21, 1970, with the SEC and one on June 19, '70, which were revealed in that congressional study. I did subpoena those and I don't see them.

MR. BROOKS: That's right, because they don't exist.

THE COURT: All right. Shall we get the jury in?

MR. BROOKS: Can I have an estimate from Mr. Beebe about what time of day he would expect to reach Mr. Spies?

MR. BEEBE: I think perhaps first thing after lunch. I might not be done with Bishop then, but I would be just a matter of a few minutes.

THE COURT: How long are you going to be with Mr. Bishop?

MR. BEEBE: I think I can run through these questions, now that we have these things out of the way, in two hours maybe. I might take a little longer if there are objections.

Why don't I make an offer of proof, sir, and we can get that out of the way also.

We have premarked the case study, 102 for identification. I handed you the entire green book but we just copied the case study out of the book. That's 102 for identification. That study represents the facts gathered by Congress and the Securities and Exchange Commission, which are the governmental bodies charged with surveillance and ultimate control over the exchange.

That study is being offered for the issue of the proper interpretation and enforcement of the federal statutes and the exchange's rules adopted under section 6 of the Exchange Act during 1968 and 1969.

It also is probative to the "oversight" issues which were raised over my objection continuously on direct examination of Mr. Bishop, and I would refer particularly to transcript pages 1881, 1887, 1889, 1892 to 94, 2020 to 23 and 2041 to 48. Also the cross-examination and colloquy at 2173 to 81.

It's also being offered, I submit, because the final report of the Senate subcommittee on securities of the committee on banking, housing and urgan affairs adopted that report in its final -- in the Senate subcommittee's final report as follows, and I am reading from pages 1 and 2 of the securities industry study dated April 6, 1973:

"The subcommittee also conducted four detailed case studies of the operation of the regulatory system inthe securities industry, focusing on the decisions involved in," then sub part 4, "the administration and enforcements of the New York Stock Exchange capital rules. These case studies, which are set forth in full in parts 3 and 4 of the securities industry study hearings, represented the first independent congressional study of how the system of self regulation with government oversight actually operates in the securities field."

The first finding, which I am also offering, is, "The New York Stock Exchange at times interpreted its net capital rule in such a way as to permit member firms to remain in bueinsss despite what would otherwise be considered violations of the rules."

I am reading, sir, from the report by the

subcommittee, not the case study itself which you have in front of you, but the report on top of that which adopted the case study.

I would also offer that report in evidence. We would call that 102A. I hereby offer both of those under, among other things, rule 803, subpart 8C of the new federal rules of evidence, which, although they do not become applicable officially until July of this year, already are thoroughly promulgated and the material supporting that particular rule show that that particular rule is already the case law at the present time.

MR. BROOKS: Your Honor, I object. I think I have said why the last time this issue came up and was ruled upon by the Court. I would be glad to summarize those points again, but I thought this had been decided in this trial, and I have seen nothing new in Mr. Beebe's presentation or in the evidence to make this admissible.

MR. BEEBE: I did not make an offer before. I referred to it in the course of the discussion about Professor Ratner and I think I have now laid a thorough foundation based on the exhibits and testimony that have come in by Mr. Bishop over my objections, which was not the case when we were talking about Professor Ratner.

There has also been thorough notice that this was going to be offered.

MR. BROOKS: Your Honor, there is no doubt about what the wit: s' testimony is and what the documents show, that the interpretation of the exchange's capital rule to McDonnell & Company. I think that is properly before the jury. But when counsel tries to put in a report which in its preface, and I hope the preface is attached to the selection Mr. Beebe handed to you --

MR. BEEBE: Yes.

MR. BROOKS: It disclaims being thorough, it disclaims being comprehensive, it disclaims being substantive and admits that it has selected selected documents from the file of another agency, some of which are not public, some of which are known to the stock exchange.

When you take a look at the documents we looked at this morning and see how they are used in this document, it's pretty plain this is a hatchet job and is not reflective of what the facts really are. Those facts are before the jury.

MR. BEEBE: I think to the contrary. The facts are set forth, especially the facts that are relevant to the enforcement of the net capital rule

in detail in this study and that the fact that it's prejudicial perhaps to the other side, it may be prejudicial in the sense that it may go against their case.

THE COURT: I am going to exclude those exhibits.

Shall we take a recess before we start?

MR. BEEBE: That would be helpful.

MR. BROOKS: I will have Mr. Spies here at 2 o'clock, unless someone wants to direct me otherwise. If I can find him.

MR. BEEBE: If I may, those two exhibits, those two documents from the exchange files, 43 and 43A.

MR. BROOKS: I don't have a dispute with Mr. Beebe on 43. I know it's in the file.

THE COURT: Do you have the report as well as the case study? Let me look at that, Mr. Beebe.

MR. BEEBE: Yes, I do. That's 102A.

Mr. Brooks, I just wanted to make clear that I am requesting that you have Mr. Spies or someone bring over, someone who is in a position to authenticate that it's in the exchange's files, the January 30th letter.

MR. BROOKS: I will bring in Mr. Spies, Mr. Beebe. I can't tell you who can authenticate what.

MR. BEEBE: And the documents.

(Recess)

(In the courtroom in the presence of the jury.)

R O B E R T M. B I S H O P, resumed.

THE COURT: Mrs. Faber, you are now called upon to fill seat number 4, if you will, and if you will all move over. You are henceforth a regular juror.

CROSS EXAMINATION CONTINUED

BY MR. BEEBE:

Q Mr. Bishop, I would like to ask you some questions about another brokerage house that failed during the paper crunch, Picard Company; do you recall that?

MR. BROOKS: I object to that, your Honor. It has nothing to do with McDonnell.

MR. BEEBE: I believe it does have to do with the same question of what was going in the industry and how they reacted and how they responded to the different problems that they were confronted with in the industry, and that is exactly what they examined about of Mr. Bishop when he was asked if this was a general problem, and things like that, and it goes to the general problem.

MR. BROOKS: But there is no testimony about Picard.

MR. BEEBE: Not Picard itself, other brokerage houses, which I objected to, and the issue was raised as to how the stock exchange reacted to the problem in the

in the industry, and that is an issue here, taking this as a standard and measuring it as against McDonnell & Company, is there a difference?

THE COURT: In a limited way I will permit it.

MR. BEEBE: It is a very short line.

BY MR. BEEBE:

Q When did the exchange first become aware that Picard & Company was in violation of the net capital rules, Mr. Bishop?

A The last two or three days of January, 1968.

Q Did there come a time in the second half of 1965, sir, that the exchange became aware that Picard was in violation?

MR. BROOKS: I object.

THE COURT: Sustained.

Q I show you, sir, Exhibit 102 which has been marked for identification and ask you to turn to page 723--

MR. BROOKS: Your Honor, what is the purpose of showing the witness this?

MR. BEEBE: To refresh his recollection.

MR. BROOKS: As I understood it, he didn't recall.

MR. BEEBE: As to the question of when they first learned that Picard was in violation. He said 1968. just submit that might help him a little.

MR. BROOKS: And an objection was sustained to the next question.

THE COURT: What page are you referring to?

MR. BEEBE: 223, sir.

THE COURT: No, I am not going to get into things that happened in 1965 with regard to another firm. We would have to litigate every firm. I am prepared to permit a limited examination as to the conditions of the industry in and around --

MR. BEEBE: This is a very limited line and it is the only other example that I propose to pursue.

THE COURT: No, because we would have to get into the entire Picard situation before it would be fair to compare them with anybody else. We are not going to litigate the Picard situation starting back in 1965.

BY MR. BEEBE:

Q Was public ownership of member firms under consideration at the New York Stock Exchange in 1969, sir?

A It became so in 1969.

Q Did the exchange apply to the SEC for permission to have public ownership of member firms?

A We filed certain rule amendments with the SEC that would permit public ownership.

Q In the course of your negotiations with the SEC

did you have occasion to meet with Mr. Pollack?

A Probably.

Q On December 11th did you meet with various commissioners and the staff of the SEC, December 11, 1969?

A Yes, I did.

Q Did you discuss with them in part the question of members giving themselves credit for restricted stock, or did anyone on behalf of the exchange discuss that question?

A I don't recall that.

Q I show you what has been previously marked Exhibit 109 for identification -- which I think I should show to your Honor first, the top of the page (handing).

MR. BROOKS: What page?

THE COURT: 2.

MR. BEEBE: Page 2.

THE COURT: Gentlemen, come to the side bar.

(At the side bar.)

THE COURT: What do you propose to do with this Exhibit 109 for identification?

MR. BEEBE: The first two major items are Mr. Haack's statement of the member firms giving themselves credit for lettered stock, which is exactly what happened with McDonnell & Company. The implication was from the

statement that they should not do it.

MR. BROOKS: I don't think that is the implication at all. Just bringing it to their attention.

THE COURT: Well, if you intend to say, does this refresh his recollection as to what the decision was with regard to lettered stock, and then what is his recollection as refreshed, I would permit that, but I won't let you use this exhibit as proof of anything.

MR. BEEBE: That is what I was going to do.

THE COURT: All right now, let's take these all at once while we are here.

MR. BEEBE: Sir, there is a whole series here on page 5 starting with Chairman Budge.

First, if he recalls this being said --

THE COURT: What being said?

MR. BEEBE: This here, this series, and ask him if it refreshes his recollection, and getting those in as admissions by the New York Stock Exchange.

THE COURT: To what?

MR. BEEBE: As to who has the responsibility if they go over the brink to allow a violation of their own rules. The New York Stock Exchange, Mr. Haack and its members have a great responsibility.

MR. BROOKS: We don't deny that. That's why we

are there.

MR. BEEBE: That's why I would like to get this in front of the jury.

THE COURT: No, this is exactly the kind of colloquy in a board meeting that I don't see as something that has evidentiary value on the issues raised by the pleadings in this case.

MR. BEEBE: This is not a board meeting.

THE COURT: But this is a meeting of people who have a responsibility for regulation of the member firms, the exchange on the first level and the exchange at the second level, and they have got problems and they are talking about what to do about it.

MR. BEEBE: And one of the things they propose to do is:

It says Chairman Budge asks to allow a violation of your rules; is that in effect one of your solutions?

Mr. Haack says: Some of the governors and our lawyers are concerned but this is the brinksmanship because of the impact on the customers if we close the doors.

Chairman Budge says: But if have a net capital rule and permit firm to accept new customers --

THE COURT: That doesn't fit McDonnell on any state of the proof, as I understand it, on this record.

MR. BROOKS: And I don't think it is clear as to what is being said at all.

MR. BEEBE: Then Mr. Haack said: Exchange and its members have a great responsibility.

Now, what we had here, your Honor, was they had a violation of the rules in January, 1969. They did accept new money from our clients, and they have a great responsibility.

THE COURT: The violation of the rules can be proved on this record competently.

No, Mr. Beebe, I will not let us use page 5 of Exhibit 109.

MR. BEEBE: Can I ask the question of whether an exchange took place concerning the rules, enforcement of the rules at that meeting?

THE COURT: No, because I don't see that the fact that it did or did not has any bearing on these issues.

MR. BEEBE: If I may just respectfully say, if a man has an admission, or the president of a company has an admission, the fact that he has an admission in the context of walking down the street or has an admission at the bar--

THE COURT: But that is not an admission that applies to this case.

MR. BEEBE: I take it as an admission that they were not going to enforce the rules.

THE COURT: No, I don't think that can be construed that McDonnell & Company was allowed to exist in violation of the rules. They had a situation where they had a lot of companies; maybe it applied to some, maybe it did not apply to others; maybe, in fact, it applied to McDonnell, but this is not a statement that in this lawsuit is permissible.

MR. BEEBE: I will take it a step at a time and go on to another one.

(End of side bar discussion.)

(In open court)

Q I believe if I can hark back to where I left off, there was a question about the entry on the top of page 2.

THE COURT: That is correct.

MR. BEEBE: May I show the entry on top of page 2 and ask the witness about that?

THE COURT: All right, go ahead.

Q Just the top of page 2, I believe, sir. Oh, you wanted to see what that was. Go ahead.

Does that refresh your recollection as to any discussion at that meeting on the subject of lettered stock.

A I understand what it says. I actually don't remember the discussion.

Q Did you or anyone at that meeting discuss the interpretation of the net capital rule, if you recall?

A I don't recall that.

Q If you will turn to the document on your right that's on the rail, page 231, sir.

Before we get into the question of whether or not that passage in the middle of the page accurately reflects --

THE COURT: Now, now, please, please. You are

making a suggestion in colloquy even. That is exactly what I don't want to have before the jury, Mr. Beebe.

MR. BEEBE: Very well, sir.

Q I will simply ask is there anything on that page that refreshes your recollection as to anything that was said at that meeting?

A No.

Q Sir, I show you Exhibit 103 for identification and ask you to turn to page 2481.

A I don't see any page so numbered.

THE COURT: 241.

MR. BEEBE: That's the transcript of Dempsey Tegler.

MR. BROOKS: You haven't given us a copy.

MR. BEEBE: I thought you had mentioned you had a copy. I have no other copy. That copy has markings on it that I am giving you. The one the witness has is unblemished.

MR. BROOKS: Proceed.

MR. BEEBE: Thank you.

Q Sir, looking at the passage there, does that remind you of anything that was said by yourself at that meeting on December 11, 1969, with the SEC?

A The meeting of December 11th with the

Securities and Exchange Commission, no.

Q If you will turn to a few pages earlier, you will see that the pending question, at page 2479 was addressed to that December 11th meeting.

A Where does that appear?

Q There (indicating).

MR. BROOKS: What page, Mr. Beebe?

MR. BEEBE: 2479 starts the series of questions.

MR. BROOKS: On which line?

MR. BEEBE: Line 9.

Q Then the statement that is read in starting at the bottom of that page and going on to page 280.

A I deny that that's related.

Q Can I have the exhibit you have in your hand?

A Yes (handing).

MR. BEEBE: I offer Exhibit 103 for identification in evidence --

MR. BROOKS: I object, your Honor.

THE COURT: I will reserve decision on your argument to the recess.

Q Just one question on that, though, to lay a foundation. Did you indeed testify at the trial of --

THE COURT: I think there is no question about that.

I will reserve decision.

Q Sir, when did Dempsey Tegler go out of business?

MR. BROOKS: Same objection, your Honor.

THE COURT: Overruled for the same reasons.

A Let me think. I think in the summer of 1970.

Q And when did Blair go out of business, Blair & Company?

MR. BROOKS: Same objection.

THE COURT: Overruled.

A I think that was also in the summer of 1970.

Q As you will recall, Exhibit 86, which is the Haack memorandum of October 1970, and the attached report mention those three firms, McDonnell, Blair and Dempsey Tegler with relation to application of the rules.

Were there any other firms not named in that memorandum to which the stock exchange did not make normal application of the rules?

MR. BROOKS: Objection.

A I don't remember.

THE COURT: Well, we have an answer at this point.

Q You say you don't remember.

THE COURT: He said he does not remember.

Q Maybe it would be helpful if I put in front of you Exhibit 86, which is this President Haack memorandum, and direct your attention to the passage on the bottom of, I believe, the third page of the report, where it says:

"In the case of three major member organizations," which are these three companies, "the exchange found itself facing situations where normal application of the rules could have meant possible loss for thousands," and so on.

How long before Dempsey Tegler went out of business did the exchange apply that plan for non-normal application of the rules to that company?

MR. BROOKS: Same objection, your Honor. Misconstrues the document and Dempsey Tegler has nothing to do with this case.

THE COURT: If you are going to go into this area you are going to have to go into it on a much more detailed basis.

Q I will ask some specific questions then.

How many customers did Dempsey Tegler have, sir?

MR. BROOKS: Objection.

MR. BEEBE: I think that is very specific and detailed.

THE COURT: Please, let's stick with the rules. Let's stay with the rules, and what is normal and what isn't normal and when.

I sustain the objection to the question.

MR. BEEBE: On the two customer questions I would like to ask, they pertain to the fact that this bulletin speaks of a total of 165,000 customers.

THE COURT: I know. Mr. Beebe, just put it my way. I am giving you a lot of latitude to litigate an entirely unrelated situation. Let's confine it for the moment to what I suggest.

Q This would be a question, then, sir, as to the point at which, in relation to the time when Dempsey Tegler went out of business, the non-normal application--

THE COURT: That's a question of finding out what the rules are that would not normally apply. Let's find out what they areand let's find out if and when they were so applied.

MR. BROOKS: I have a further objection. This document only says "normal application of the

rules" could have meant certain things occurring. It doesn't say there was any abnormal application of the rules to anybody.

THE COURT: That's why I want him to lay a foundation as to what, if anything, was done.

MR. BEEBE: I would disagree with that document.

THE COURT: Put a question.

Q Let me ask you, Mr. Bishop, did there come a time when Dempsey Tegler was in violation of any stock exchange rule?

MR. BROOKS: I object.

MR. BEEBE: I believe that's exactly the area that I am --

THE COURT: No, it isn't.

Mr. Bishop, taking this word or words "normal application of the rules," I gather there came a time as to Dempsey Tegler you may have had a non-normal application of some rules?

THE WITNESS: Perhaps that's true. I don't really remember Denpsey Tegler at this moment very well.

THE COURT: Do you have any memory of any non-normal application of the rules in Dempsey Tegler?

THE WITNESS: I just can't remember the

events leading up to Dempsey Tegler's failure well enough to know.

Oh, yes, this was Mr. King. Let me see.

There was a period in the winter of 1969-70 where we permitted Dempsey Tegler to be in capital violation while we were expecting new capital to come in, which eventually did come in but it was a longer time than we usually would have waited. That might have been construed to be that kind of event.

That's the only one I can think of.

MR. BEEBE: Could we ask the same question as to Blair?

THE COURT: Yes. Would you answer that asto Blair?

THE WITNESS: Blair, I don't recall that there were any. Their demise was rather quick.

Q Now, during that period, '69-70, while you were waiting for new capital at Dempsey Tegler, did you inform the potential lenders that the rules were not having the normal application?

A What potential lenders?

Q You said you were waiting for new capital to come in. The new capital contributors, did you inform them?

A No.

Q Were you in attendance at a meeting on November 4, 1968, between the Securities and Exchange Commission and the New York Stock Exchange concerning back office problems?

A I don't identify that meeting, if there was one.

Q If you will look at -- I better get the number Exhibit 102 on page 28, 102 for identification.

A The page numbers seem to run in the 200's.

Q 228, sir. The paragraph on the left starting "As 1968." That is all I will read out of it.

(Pause)

MR. BROOKS: Is the question whether the witness was present?

THE COURT: Have you looked at those paragraphs?

THE WITNESS: Yes.

THE COURT: What is the question based on?

MR. BEEBE: The first question is whether he was there.

THE COURT: Where?

MR. BEEBE: At that meeting, November 4, 1968.

THE WITNESS: I don't remember this description.

Q Were you told or do you remember being told about that meeting back at the exchange?

A I just don't remember it at all. I have read this report before but I don't remember this meeting.

Q Now, you see right on that page above there is reference to a letter dated December 9, 1968.

A Yes, I see it.

Q Did you or your counsel bring that letter with you today?

MR. BROOKS: Your Honor, havnn't we discussed this?

THE COURT: Yes, we discussed this letter already. It's been marked for identification as 110.

MR. BEEBE: Could we hand it to him? I don't believe I have had access to that one.

THE COURT: That was the one I ruled that I wasn't going to let you have access to.

MR. BEEBE: That's right. So I am asking if the witness -- I am trying to, without approaching the document, ask the witness if he had ever seen that document before today, as a start to get a foundation going.

THE COURT: Here is 110 for identification (handing).

A What is the question?

Q Did you ever see that before today?

(Pause)

A I'm not sure.

Q In the normal course of procedures in late 1968 would that document have been routed to you as head of the department of member firms, or a copy of it?

A I should think that it would have.

Q Do you recall at that time receiving information to the effect of what was in that document?

MR. BROOKS: I object to that question, your Honor.

MR. BEEBE: Well, just as a foundation.

May I pinpoint the attention that I am interested in?

THE COURT: Just a second.

(Pause)

THE COURT: Mr. Beebe, here you are (handing).

MR. BEEBE: Thank you, sir.

Q Was this --

THE COURT: Now, I have already ruled on the admissibility of this letter. If I didn't, I now

rule that letter in and of itself is not admissible. So govern your examination accordingly. I am only giving it to you because it seems to me silly to conduct it in this fashion. But the letter itself I do not deem admissible.

Q Sir, I believe the pending question was whether --

THE COURT: The matters contained in that letter came to his attention.

Q Yes, the information. And I will give it to you (handing).

MR. BROOKS: Your Honor, I have a problem with that question because the letter talks about a lot of generalities which could have come to Mr. Bishop's information or to his attention from any source. Is the question whether they came from this source or whether they came by osmosis from the general world?

MR. BEEBE: I will narrow that to say the information in that letter from that source, that he learned that that source had said what was said in substance in that letter, either by receiving a copy of it or otherwise.

THE WITNESS: To that question I would answer I don't recall it.

MR. BEEBE: If I may move along, I will look at this a little later.

Q Now,sir, in July of mid-1968 did the Securities and Exchange Commission urge the New York Stock Exchange to increase the size of the special trust fund?

MR. BROOKS: I object.

THE COURT: Yes, sustained.

Q On January 29, 1969, did the stock exchange send to the SEC a list of firms that were on restriction?

A I don't remember that.

Q Could you look at page 229 of Exhibit 102.

A Where?

Q On the bottom of the page going over to page 230.

MR. BROOKS: Is the question, does this refresh his recollection?

MR. BEEBE: As to whether as the man at the head of the department a list was sent on or about that date.

A Are you asking me if I accept the date in this document?

Q On or about that date --

THE COURT: Does this document refresh your recollection that on or about January 29, 1969, the exchange sent the Commission a list of firms on restriction?

THE WITNESS: No, it does not refresh my memory.

Q And you don't know that independently?

THE COURT: That is what he says.

A That's correct.

Q Was it the normal course at that point to send lists to the SEC of firms on restriction?

A I believe it was. We had one exhibit that showed it.

Q Well, McDonnell & Company didn't appear on that list until it was placed on restriction, is that correct?

MR. BROOKS: I object.

MR. BEEBE: It is cross-examination. I am just trying to move that along.

THE COURT: Well, we have a certain letter, a footnote, as I remember, that makes this question a little bit broad in its scope.

MR. BEEBE: I don't know if we were given copies of that.

MR. BROOKS: I think you were.

Q Just bearing with that as yourrecollection that there was such a footnote, what was the date of that letter with the footnote about McDonnell & Co.; do you remember the time frame?

MR. BROOKS: I object.

MR. BEEBE: All right, then, can we have the exhibit then? I think it was 00. That seems to stick in my mind.

MR. BROOKS: It would have to be 000.

MR. BEEBE: Well, let me pursue a few other questions I have in this area --

MR. BROOKS: Here you are, Mr. Beebe, 000 (handing).

Q That is dated April 25th, I believe, 1969.

Was there any notification to the SEC before then that McDonnell & Company had placed itself on voluntary restrictions?

A I don't know.

Q Normally it would have appeared in that same file, would it not, if there was a prior notification of that sort to the SEC?

MR. BROOKS: Objection.

THE COURT: Sustained.

Q Did you attend a meeting of the top management of the exchange with the SEC on April 21, 1970, which again discussed the net capital rule?

A No.

Q Do you know definitely that you did not attend that meeting?

A Yes.

Q If I could ask you, would it do any good to ask you to look at the page to refresh your recollection, or is that --

THE COURT: Show him the page.

MR. BEEBE: Page 232 of Exhibit 102.

A Where?

Q Starting at the bottom of the page and reading all the way down to the bottom of the quote --

MR. BROOKS: Your Honor, to shortcut that, why don't we ask the question how Mr. Bishop is sure he did not attend that meeting? Why don't we ask him how he is sure he did not attend this meeting?

A This does not refresh my memory.

THE COURT: It would be an appropriate question for redirect examination.

MR. BEEBE: I don't mind ask him that.

Q How are you sure you did not attend that meeting?

A I was visiting colleges with my daughter in that week.

Q Did you hear a report about the meeting when you got back?

A I don't recall.

MR. BEEBE: We have subpoenaed any notes of that meeting. Can we have them produced now, memoranda and reports?

MR. BROOKS: We have covered this before on the record and I said that no reports existed.

THE COURT: Yes.

Q Did you attend and give a thorough briefing to the SEC staff in June, 1970?

A The answer to part of that question --

MR. BROOKS: I object. June, 1970? You can do

better than that.

MR. BEEBE: No, we can't do better than that. June, 1970, and I refer to page 234.

MR. BROOKS: A thorough briefing on what?

MR. BEEBE: On financial problems.

THE COURT: Aren't you getting a little bit beyond the time frame now?

MR. BEEBE: I believe it goes back into the period, especially subparagraph 4 of that series.

MR. BROOKS: I don't think that paragraph or any other discussion at such a meeting could be relevant to the problems of McDonnell.

THE COURT: Yes.

MR. BEEBE: I think, your Honor, you can see in the first sentence of subparagraph 4 why it directly relates--

THE COURT: No. I sustain the objection.

Q Sir, was it your view in 1970 as an officer of the exchange that some firms were too big --

THE COURT: No, no, Mr. Beebe. I thought my last ruling made that perfectly clear.

MR. BEEBE: This is from a different--

THE COURT: I know, but we are talking about a subject matter. You pointed my attention to a subject matter. Are you going to the same subject matter as that

paragraph 4, first sentence?

MR. BEEBE: Before I ask this question may I direct your attention, sir, to page --

THE COURT: Come around to the side bar, please.

(At the side bar.)

THE COURT: I want to make an observation. We are not trying the industry; we are trying one company.

I don't care whether this man feels that some firms are too big to regulate, the jury is going to have to determine whether their regulation of McDonnell was proper or improper. If McDonnell was too big to regulate and they didn't regulate it, who cares whether it was too big? They didn't do it. That's the point. To ask him whether it is his view, as he sits here today that some firms are too big to regulate, even if they asked him in 1969, the question is what was done, not whether he felt, my gosh, I am on top of something I can't control.

MR. BEEBE: Well, the kind of thing I am trying to prove, which I introduced some proof of is not the kind of thing people sit down and write convenient memos on where they say we are just going to suspend enforcement of the rules and they are not going to enforce them as to McDonnell, and the subordinated lenders be damned. People don't do that.

Now, this next question is from the Dempsey Tegler

transcript where he says at the top what that quote in there is meant to be, and what it meant to be was that they were too big to liquidate. That is precisely what happened here, we say, and here is another admission --

MR. BROOKS: Did he say that about McDonnell?

MR. BEEBE: -- by an officer of the exchange that their attitude that when firms got too big -- and McDonnell was one of them -- they were not going to liquidate them. It all dovetails with what Arning said. But I don't prove it by having some memo that says it straight out.

MR. BROOKS: I think the way to prove what happened at McDonnell is to take the McDonnell facts in the documents and the testimony of the witness and ask the jury to draw conclusions from those McDonnell facts.

MR. BEEBE: That is the exact problem here, that the facts are at best ambiguous, and they argue other inferences from those same facts, so what we have got to do--

THE COURT: It doesn't say too big to regulate.

MR. BEEBE: That's right.

THE COURT: And he even says that he is misquoted in saying "too big to liquidate."

He says: "I have previously said that is incorrect."

MR. BEEBE: "Too big to regulate."

THE COURT: "Q Do you remember the phrase 'too

big to liquidate,' page 2522?

"A I remember the phrase appearing in some government declarations and I previously said that it is incorrect.

"Q I believe you indicated before you did not say too big to regulate. What you said was too big to liquidate, and what you meant was that some firms were too big to liquidate before you had the public money into the brokerage firms?

"A No."

MR. BEEBE: And then the next page they finally get into an admission. The man does not admit things too readily, as your Honor is aware. That is the sense of it--

THE COURT: In order to change the phrase from "too big to regulate"to too big to liquidate?

MR. BEEBE: Yes. That was the sense of the conversation. So we phrase the question to narrow it down to that very specific point, and that is the very specific point.

THE COURT: But you are now going back an entire page and adding in "before you had the public money into brokerage firms."

MR. BEEBE: That is the part he denies, so I didn't ask him that. I am just asking him the last part, "too big to liquidate."

MR. BROOKS: Why were you asking him about regulating?

THE COURT: Why were you asking him about too big to regulate?

MR. BEEBE: Because that is what he said.

MR. BROOKS: He denied it.

THE COURT: He denied it.

Mr. Beebe, let's not waste time. This is already in Exhibit 86, which is already in evidence.

MR. BEEBE: I hope Exhibit 86 is as clear as I think it is, because they seem to --

THE COURT: He never incorporates "too big to regulate."

MR. BEEBE: But he does say "too big to liquidate."

THE COURT: All right, we are down to that.

(End of side bar discussion.)

MR. BEEBE: Mr. Reporter, would you be able to find how I started to phrase the last question?

THE COURT: Why don't you put a new question.

MR. BEEBE: All right.

BY MR. BEEBE:

Q Was it your position as an officer of the exchange that some firms were too big to liquidate?

A No.

Q Did you ever testify to the effect--

MR. BEEBE: Perhaps we better wait. We are going to have a discussion at recess anyhow about this transcript anyway, to save time.

THE COURT: All right.

Q Sir, if several large firms -- in the first place, was McDonnell & Company a large firm, a medium size firm or a small firm of the member firms?

A Medium -- a largish medium firm.

Q If several firms of that general size ceased business in the period 1968 or 1969, would that have had a substantial impact on the securities industry?

MR. BROOKS: Objection.

THE COURT: Yes, sustained as to form.

Q Did you ever take a position, express a view as to the impact the failure of several firms of that size would have in 1968 or 1969?

MR. BROOKS: Objection.

THE COURT: Sustained.

Q Would the failure of several firms of that size in 1968 and 1969 have had an impact?

MR. BROOKS: Objection.

Q As you are sitting right here.

THE COURT: He may answer yes or no. I will allow it.

THE COURT: It seems to me Exhibit 86 seems to have included this question and answer.

MR. BROOKS: But not in 1968 or 1969. And I object to the word "impact." Impact on what?

THE COURT: Yes, I sustain the objection.

MR. BEEBE: I will correct it based on Mr. Brooks' objection.

Q Would it have an impact on the securities industry?

MR. BROOKS: Objection.

THE COURT: At what time?

MR. BROOKS: In 1968 or 1969.

THE COURT: He may answer.

A Could I hear the question please? I don't know what it is, it is so disjointed.

Q Would you like me to put it again? Would that make it easier for you, or do you want to answer it now?

A I would like to know what it is.

Q The question is --

THE COURT: Mr. Beebe, look at the top of the second page of Exhibit 86.

Are you going to go beyond that?

MR. BEEBE: The question has been raised as to whether that was in operation as to McDonnell & Company in

1968 --

THE COURT: No. Your question does not go beyond what is included in the top third of that page, your present question. In fact, it is much more general. Exhibit 86 is much more specific.

MR. BEEBE: My present question is aimed at the period 1968 and 1969. I guess that is included in 86.

You see, my question is aimed at the 1968, 1969 period to put to bed any question as to whether Exhibit 86 applied to McDonnell & Company in that period.

MR. BROOKS: I don't think the question is put to bed.

THE COURT: I don't think it does.

MR. BEEBE: I think it moves that along and if it gets an answer that is affirmative it would assist in this regard.

THE COURT: No, I think it is much too general. I am going to sustain the objection.

BY MR. BEEBE:

Q Did there come a time in January, 1970, when the SEC conducted what is called a "net capital inspection"?

MR. BROOKS: I presume you mean of the New York Stock Exchange?

A I don't remember January of 1970 as the specific

time. They did it from time to time.

Q They did from time to time conduct-- it was every few years that they would conduct one of these net capital inspections?

A I don't really know anything that is known as a net capital inspection. We spoke about an oversight visit a day or two ago, and I assume you are talking about the same type of thing.

Q No. I direct your attention to Exhibit 102 at page 222.

A Which part?

Q The last full paragraph that ends on that page, not the one that carries over to the next page.

A I don't see anything about that. Maybe I don't have the right paragraph. It starts with C, Beginnings of Financial Crisis?

Q No, above that.

THE COURT: Here(indicating).

Q Particularly the sentence--

THE COURT: Just let him read the paragraph, please.

MR. BEEBE: Okay.

THE WITNESS: Now, what was the question?

Q Do you recall that there was such an inspection at all about that time?

A I still don't recall it.

Q Were you ever made aware of a report at or about that time?

A I don't recall -- you mean this report --

MR. BROOKS: I object.

Q Yes, that report.

A I read this report when it was originally published by someone --

Q No, I'm sorry, I mean the report that is referred to in the paragraph you just read.

A That I don't recall.

Q Was your department in charge of enforcement of the net capital rule at the New York Stock Exchange at that time?

A Yes.

MR. BEEBE: I may have one or two more questions about 102 for identification, your Honor, but based -- that is the document we just were looking at-- but based on the testimony this morning and the particular passages I now reoffer 102 in evidence.

THE COURT: No, I exclude it.

Q Did there come a time on April 29th when the SEC wrote to the stock exchange concerning application and enforcement of Rule 325?

MR. BROOKS: Can you fix the year?

MR. BEEBE: 1970.

Q And I show you a document which had previously been marked as104. It is not one that emerged this morning.

A What is your first question?

Q My first question is, did you become aware of this document through routing or otherwise shortly after April 29, 1970?

MR. BROOKS: The witness was just shown a document. This question is different.

THE COURT: We have a new question.

A Probably.

MR. BEEBE: I offer that as the plaintiffs' next exhibit in evidence.

MR. BROOKS: I object, your Honor.

THE COURT: Yes, objection sustained.

Q Do you still have that in front of you? I have one more question. On the last page there is a paragraph numbered 12.

MR. BROOKS: Your Honor, since the witness has not testified to seeing this document and it's not in evidence, I think the proper way to ask the question is to simply ask a question, without reference to the document. Then depending on whether the answer is one way or another, then perhaps reference to the document might be appropriate.

THE COURT: That's generally the way.

Q Did the SEC, without reference to that document, in April 1970 --

THE COURT: You had better come around here to the side bar and tell me what question you are going to ask.

(At the side bar)

MR. BEEBE: There is a whole line and we might as well do all of them right now.

THE COURT: What was the question going to be, did the SEC in April 1970 what?

MR. BEEBE: With regard to the exchange's interpretation of the rules and there arefurther letters to the same effect.

Now, the relevance of all this is that the SEC oversight issue was raised on Mr. Bishop's direct, and it hovers as a kind of latent excuse somehow that they tried to interject in this case. The excuse being we told everything to the SEC, they didn't do anything about it and therefore it must have been okay.

This shows just the contrary and I ought to have a chance to prove it.

THE COURT: Mr. Beebe, do you argue, and forget the original oversight, do you argue that the exchange's opinion -- I mean the commission's opinion of what the exchange was doing four months after McDonnell's demise is a statement of fact that the jury can consider on the issues of this litigation?

MR. BEEBE: On the four months part, your Honor, I think all of these go back to the '68-69 time period.

As to the relevance?

THE COURT: No, as to its competence to prove something here. This is a statement of opinion by people at the commission after the event, saying you didn't do this, that and the other and you should have done it. That would usurp the jury function, for one thing. You don't know the motives of the commission in

perhaps wanting to put everything off on the exchange where they are apparently caught in a two-way fight between themselves and Congress and possibly the exchange. I just don't see it. This is a sheer expression of opinion by a government agency saying you didn't do this, that and the other.

MR. BEEBE: If it were some outside agency, that would be one thing, like Ralph Nader. It says it's a summary of findings made by the staff.

THE COURT: We have a jury here to make some findings. You want to substitute the exchanges findings for the jury's findings?

MR. BEEBE: I don't know what I would do about this SEC oversight issue for one.

MR. BROOKS: Talk about McDonnell for one.

MR. BEEBE: This is the whole industry. This is how they were and weren't enforcing. This was what the SEC was getting mad about, and Congress, that the exchange was not enforcing it that way. The Haack memo shows that McDonnell was one of the leaders that they weren't doing anything about.

THE COURT: Let's assume for argument's sake that the exchange was applying this rule miserably and the commission was getting all of these reports and

should have known that they were applying it miserably. Can you then say to the jury that you have to find for my clients because, look, here is where the commission itself said this stuff was miserable?

MR. BEEBE: It's fighting fire with fire as far as that argument is concerned. What is Mr. Brooks going to say about this oversight? That's the problem I am faced with.

THE COURT: He is going to argue we were doing our best and the SEC was looking in on this.

MR. BEEBE: That's the part I find troublesome.

THE COURT: The answer to that certainly can be on this record that the SEC must have dropped the ball because here are the rules and this is a violation of these rules. I don't care whether the SEC was looking or wasn't looking. The rules were violated.

MR. BEEBE: When the jury is given that poisonous testimony on the other side, I agree that the issue 100 per cent before this jury is what happened here with McDonnell and Company. They brought it in about the SEC and I have to fight that.

THE COURT: That doesn't open the door to a hindsight statement of opinion.

MR. BEEBE: That's why I'm trying to put in the case study, too.

THE COURT: I usstain the objection to it.

MR. BEEBE: I will have another one, which is the next document. I guess I will just offer it just for the record.

THE COURT: Offer it on the same basis and for the record I will rule on it.

MR. BEEBE: It's a little later after the Haack memo comes out. In October the SEC chairman writes a scorching letter to the New York Stock Exchange president, who I tried to subpoena, by the way, but he is too far away.

MR. BROOKS: You didn't ask us to tell you where he was and where you could subpoena him.

MR. BEEBE: I asked for him.

So in any case, the next letter is by the chairman.

THE COURT: Did you take Mr. Haack's deposition?

MR. BEEBE: I didn't bother. We deposed 42 people. I wish we had taken that testimony. I thought they would produce him when he was named in the caption of the case, but they wouldn't do it.

In any case, I will offer the letter from the chairman and we will take a look at that.

(In open court)

BY MR. BEEBE:

Q I believe I will just go on to the next document. I show you Exhibit 105 for identification.

A (Reading)

THE COURT: Same ruling.

Q Going on to another area, I show you a letter that was offered on direct examination from T. Murray McDonnell to yourself dated November 19, 1970, Exhibit WWW.

I would like to read a little from this.

MR. BROOKS: I object, your Honor. When I tried tointerrogate the witness on this letter, and the response to it, Mr. Beebe objected and was sustained. I believe your Honor commented at that time that what relevance did the enforcement proceeding against T. Murray McDonnellhave for the events that had occurred nine or ten months earlier.

MR. BEEBE: That's not what I am going to read from. I am going to read from this exhibit in evidence.

MR. BROOKS: Same objection.

THE COURT: The exhibit is in evidence. Is

that right?

MR. BEEBE: Yes. They offered it in evidence and I would just like to read from it.

THE COURT: Are you reading it as part of the examination of this witness or are you just reading it because at this point it happens to be something you want to read?

MR. BEEBE: I would say in all fairness, sir, it's both because they introduced the exhibit, which I had planned to introduce myself. If I had introduced it I would have taken on the occasion of introduction to read it. But they didn't do it and here I am on cross. I want to read from it since it's already in evidence. I do have some questions to the witness about it, but I think that's the only fair way for me to do it.

THE COURT: I don't remember the circumstnaces when it went in that you weren't permitted to read from it.

MR. BROOKS: I didn't read from it.

THE COURT: I say, I can't place the circumstances under which you were not premitted to read from the exhibit in evidence.

MR. BEEBE: May I tryand refresh as we

stand here? Maybe I should just summarize the circumstances, as I remember.

MR. BROOKS: I have the transcript here. It begins on or about page 2072 and goes up two or three pages thereafter.

MR. BEEBE: I think it's better to start on 2071 with the question.

He did read, on page 2070, he read right from it and I didn't object to that.

(Pause)

MR. BEEBE: 2069 was a place -- it's clear on 2069 what the exchange was about.

THE COURT: After you read this are you going to ask Mr. Bishop any questions about his letter?

MR. BEEBE: I am going to ask him three questions.

THE COURT: What are they?

MR. BEEBE: What are the three questions?

THE COURT: What would they generally encompass?

MR. BEEBE: They relate to when McDonnell & Company was permitted to continue in operation despite violations, they relate to McDonnell's size, and they relate to the special trust fund.

THE COURT: Well, none of these have anything to do with this letter. So you may ask the questions and I will reserve the reading of the letter for your summation.

MR. BEEBE: All right, your Honor.

Q Mr. Bishop, is it your position that the exchange permitted McDonnell & Company to continue in operation despite its violations only in 1970?

MR. BROOKS: I object.

THE COURT: No, overruled.

A It doesn't seem to be a very clear question. The way it reads, we permitted McDonnell to continue in business for 30 or 40 years.

THE COURT: Mr. Beebe, you better rephrase your question.

Q You testified on direct examination that there was a time in 1970 when there was non-normal application of the rules as to McDonnell & Company. That's what I am referring to.

THE COURT: That's correct.

A What is your question?

Q My quetion was was it only in 1970 that you made the non-normal applications of therules as to McDonnell & Company?

A I believe that's correct. About six weeks, in March or something like that.

Q How many customers did McDonnell & Company have at thatpoint, when, I believe, it had only three branches?

A I think it might have had as much as 20,000 left over from the branches that had been closed. It didn't have very many that were still active.

Q It was down to three branches, was it not?

A I don't remember if it was three or one by then.

Q And when it actually closed its doors on March 13, 1970, how many customers did it have?

A I just answered that.

Q That was the 20,000?

A Something in that neighborhood. I think I answered that several days ago and said that the 20,000 or thereabouts, many of them were just left over pieces of accounts that hadn't been delivered yet.

Q Were they delivered out before the liquidation proceedings started?

A Virtually all of them.

Q How many of them were left to be handled in the liquidation proceeding after the others were delivered

out?

MR. BROOKS: There is no foundation for the question, so how is the witness competent to know?

MR. BEEBE: The witness was certainly in charge of this operation.

THE COURT: Put another question.

Q The question is on the size of the firm when it was actually closed down, the last day, and after the accounts were delivered out how many customers were there at that point?

A After the accounts were delivered out?

Q Yes.

A None.

Q Who made up the body of customers who made a claim against the special trust fund?

A I don't believe any --

MR. BROOKS: Objection. No foundation for this witness to answer that question.

THE COURT: Sustained as to form.

MR. BEEBE: The witness testified, I believe, as to the amount of payments that were made by the special trust fund with regard to McDonnell & Company customers. I am trying to find out, just for clarification, if you will, how many customers there were.

THE WITNESS: I don't recall that. I don't know that we ever counted them. Many of those customers were getting their own property back. They didn't get any assistance from the trust fund.

THE COURT: Mr. Bishop, do you have any idea of how many customers were paid out of the trust fund?

THE WITNESS: No.

THE COURT: There is a list, I assume, somewhere?

THE WITNESS: I doubt that there is. It was too complex to keep a list.

THE COURT: Somebody had to account for it, didn't they?

THE WITNESS: There might have been a list of people who got checks for cash. When we bought securities, for example, we didn't really know in all cases with trust fund money or with their own money, the firm's money. Liauidation is very complex. We didn't try and keep a special checking account for the items the trust fund paid.

Q Let me ask you, without being any more precise is it fair to say that the liquidation would have been much more complex in January 1969 than it ended up being

in March 1970?

MR. BROOKS: I object.

THE COURT: No. Overruled.

Go ahead.

A Would it have been more complex?

Q You hesitate --

THE COURT: Mr. Beebe, leave your question on the floor for a moment.

(Pause)

A That's very difficult to say. I don't know that I have an opinion on that.

Q I am going on now to the question of stock exchange issued an annual report for the year 1970. I show you Exhibit 106 for identification and ask you if that is the exchange's annual report for that year.

A It appears to be a Xerox of it.

MR. BEEBE: I offer that.

MR. BROOKS: I object.

THE COURT: Ladies and gentlemen, we will take our luncheon break now.

You may step down, Mr. Bishop.

(Jury leaves courtroom)

THE COURT: Now, what is the purpose of this

offer? What page or pages do you really want to use as part of this record?

MR. BEEBE: There is a page 3, I guess, if you count the cover as the first page and it has a heading, "The end of an era," and I will read it.

"In a sense we have come to the end of an era. This industry will never be the same as it was before 1968 and perhaps that is just as well. The day of the casually managed brokerage firm is over. A tolerant or uninformed attitude toward inefficiency has no place in the securities business that has survived the recent floodand the drought that followed in its wake."

That's it.

THE COURT: That is what you want?

MR. BEEBE: That's what I want, your Honor.

THE COURT: Just that one paragraph?

MR. BEEBE: That's right, your Honor. I will take those first three pages --

MR. BROOKS: Those are fine sentiments, your Honor, but I don't see how they relate to our lawsuit.

MR. BEEBE: It's an admission by the exchange, going back to 1968, about "a tolerant or uninformed attitude."

THE COURT: I will think about it over the luncheon recess.

2 o'clock.

MR. BEEBE: Sir, should we talk at some point about the various things we put aside, about the Dempsey transcript, the questions I was pursuing?

THE COURT: I will look at that as well.

(Luncheon recess)

slh 1

AFTERNOON SESSION

2 P.M.

(In the courtroom in the absence of the jury.)

THE COURT: Now I am going to rule out 106. I have considered it over the lunch hour.

MR. BEEBE: Excuse me, which was 106?

THE COURT: That is the stock exchange report for 1970.

Now, what is it that you want from the exhibit which is the exhibit Dempsey-Tegler testimony of Mr. Bishop?

MR. BEEBE: There was a gathering of several things. Taking them in sequence -- could we have Mr. Bishop step out?

THE COURT: Yes. Mr. Bishop, would you step through the door please.

(Mr. Bishop leaves the courtroom.)

MR. BEEBE: I hate to ask that every time, but I just don't know how else to handle it.

At the bottom of page 2481 at the end of that paragraph he said in that sworn testimony very clearly: "If member firms' capital could be improved in the way that public ownership would permit that our staff would then turn 180 degrees in wanting to strengthen the capital rules, which we did."

He denied having said that.

Now, I have a sworn statement that he did say that.

MR. BROOKS: Your Honor, that is not what he testified to this morning. Mr. Beebe asked him something about a meeting in December of 1969. Then he said: "Do you recall saying that at the meeting?"

MR. BEEBE: That's right.

MR. BROOKS: Mr. Bishop said "No, I do not."

MR. BEEBE: That's exactly right.

Then I put this in evidence to establish that he did, indeed, say it, and I put it in because it comes straight out the transcript of another trial where he testified under oath, unlike other things we have, your Honor, where Mr. Bishop questions whether he was correctly quoted or not, here we have his sworn testimony --

THE COURT: Where does this tie in with the--

MR. BEEBE: The earlier line?

THE COURT: No, that particular meeting.

MR. BEEBE: Back on the first page of the exhibit, sir, 2479.

Then they read a statement to him which comes straight out of the case study. That is Mr. Augustine reading.

s1h3

And then they have the footnote which he denies that it is accurate.

And then they ask him about the substance of it, and finally they get that concession out of him at 2481 that that is his version of what he did say.

MR. BROOKS: Your Honor, not at that December meeting. That has nothing to do with it. We leave the December meeting at the bottom of page 2479.

MR. BEEBE: Well, the way I read it, the December meeting was talking about him being quoted, or, he says, misquoted.

He further stated that once public ownership was approved and put into effect for membe firms the staff would shift their position 180 degrees on the interpretation of the exchange's net capital rule. And then he concedes that at some point, whether it is the December meeting or September meeting, he did say that, that's all.

THE COURT: So he said it, then what? This has to do with if there was public ownership of member firms.

MR. BEEBE: Right, and the point there, your Honor, is that he was being pressed, and he was pressing in turn in 1969 to get public ownership, and he said, "I will give you a quid pro quo. If you will give me -- if I can get public ownership then I will turn 180 degrees and I will

s1h4

enforce things; I will strengthen the enforcement of the rule."

MR. BROOKS: It doesn't say enforcement, enforcement of the rule itself. I think it goes on in the transcript to say that they subsequently reduced the maximum ratio to from 2,000 per cent to 1,500 per cent. That's after the demise of McDonnell and has nothing to do with our case.

MR. BEEBE: I think what we are arguing is more of how one interprets what he said rather than whether or not he did say it. If you were referring, sir, to the case study, 102, it is on page 231, the case study, that's where it all begins.

THE COURT: You have lost me.

MR. BEEBE: At 221 of the case study he is quoted and he says not completely accurately, that the exchange was under great pressure to interpret the rule as loosely as possible, and that the exchange would shift their position 180 degrees on the interpretation of the exchange's net capital rule if they got public ownership.

THE COURT: He says he is misquoted, I gather, on the word "interpretation".

MR. BEEBE: Well, what he thinks he was being misquoted on - he never adopts the first part of that sentence in the testimony they elicited out of him in

s1h5

Dempsey-Tegler, the first part being they were under pressure to interpret the rule loosely. I have not been able to verify one way or another what if anything was said along those lines, and he does not help us as he sits here. But the latter part he did adopt on page 2481 of Dempsey-Tegler.

THE COURT: He said it would strengthen it. Not a question of interpreting it; it would strengthen it.

MR. BEEBE: He would turn 180 degrees in wanting to strengthen it.

THE COURT: Yes, wanting to strengthen it.

MR. BEEBE: And as I read that, 180 degrees in the other direction is not wanting to strengthen it.

THE COURT: Not wanting to change it from what it was.

MR. BEEBE: 180 degrees to me means the opposite.

THE COURT: That's correct.

MR. BEEBE: And the opposite of strengthening is weakening.

THE COURT: Not necessarily. The opposite of strengthening is leaving it as it is.

MR. BEEBE: I think the jury might find that he was saying that they were not enforcing it vigorously at that point.

sl h6

THE COURT: Well, I will let you examine in this area but I am not going to let you put in the deposition as an exhibit.

MR. BEEBE: It is not a deposition; it is testimony at trial.

THE COURT: Testimony in Dempsey-Tegler, 103, and I don't want you to read into the record any testimony that he has heretofore stated that he rejects.

MR. BEEBE: I believe,your Honor, that I never did that this morning. The time when you interrupted me I was about to use the word "liquid" not "regulate."

THE COURT: Okay.

MR. BEEBE: Now, while we are on this, we also preserved questions which we might as well address ourselves to right now.

On page 2532 and page 2533 is his testimony saying "I didn't say 'too big to regulate'; I said 'too big to liquidate.'"

THE COURT: Yes?

MR. BEEBE: And I don't believe that I was able to pursue the questioning in that area.

THE COURT: I thought you had.

MR. BEEBE: I had? All right.

THE COURT: I thought you had.

s1h7

MR. BEEBE: All right, let me bow out of that one.

And the final one I know I didn't get to pursue is 2538 and 2539.

You see, he was talking specifically about McDonnell. They, of course, having Exhibit 86 with them out there, and they were asking about these three, McDonnell, Dempsey and Blair, and they asked him, and that is where I had that line of questioning from. 1968 to 1969 is what he said out there.

You were saying to me this morning, sir, well, doesn't Exhibit 86 say the same thing.

I agree with you, I think it does, but I have heard many arguments on the other side, and Exhibit 86 and his testimony seems to try to limit the action of McDonnell & Company to those few months in 1970 --

THE COURT: That is what he said as to their action.

MR. BEEBE: That is what I say is contradicted.

THE COURT: This has to do with the impact on the country, which is something entirely different.

MR. BEEBE: I think it is contradicted right here because what he is saying here is, way back in 1968 if these companies, the three companies of this size, were put under, it would have had a substantial impact, i.e., we were motivated at that point in 1968 and beginning of 1969

not to put them under, not to enforce the rules, and that's exactly the point that I am trying to hammer home, and I submit this helps, substantially.

MR. BROOKS: It takes quite bit of fixing, your Honor, to get from this quote to where Mr. Beebe ended up. He is not even talking about these three firms in question. He is talking about any several large firms.

MR. BEEBE: I couldn't differ more. This exhibit, the transcript of the Dempsey-Tegler trial, on the bottom of 2538 says:

If Dempsey, McDonnell and Blair went under--- and he asked him only about 1969 --

"Did you believe there would have been chaos in the industry?

"Yes.

"Did you believe that in late 1969?"

Well, he says in his other trial where there were different issues, "I don't know whether I tied myself down to three firms in the specific period. I certainly did believe if I said several firms ceased doing business in 1968-1969, it would have a substantial impact, perhaps cause a national financial panic."

That's what motivated him and the exchange to act and not to act, the end of 1968, the beginning of 1969.

That's what I am trying to prove to the jury.

MR. BROOKS: I think it just makes the point I just attempted to make. He is not talking about three firms; he is not tying him down. He is talking about if several large firms cease doing business in that period.

MR. BEEBE: The McDonnell Company was a medium to large firm and was one where they finally did act by their own admission in that way, in Exhibit 86. This is not some hypothetical out of the blue; this is right in this industry in this area in this country.

THE COURT: Let me get back to that after a couple of minutes.

(Jury present)

R O B E R T M. B I S H O P resumed.

THE COURT: Go ahead, sir.

CONTINUED CROSS EXAMINATION

BY MR. BEEBE:

Q Sir, I hand you Exhibit 111 for identification, which I believe was produced by your counsel pursuant to the request to go to the SEC files; is that where this came from?

MR. BROOKS: Mr. Bishop's secretary undertook the search. I understand that's where she found that. It's hearsay, your Honor. In any event, it's here.

Q Can you shed any light on why this wasn't produced before? That's really my question.

A No.

MR. BEEBE: I offer 111 as the next exhibit.

MR. BROOKS: I don't have an objection to it coming in, your Honor. I note Mr. Bishop hasn't identified it yet.

It can go into evidence.

(Plaintiffs' Exhibit 111 was received in evidence)

Q Sir, was this part of the material that the stock exchange sent down from time to time to SEC about McDonnell & Company in 1969?

A I think this was pursuant to a specific request, but it was in general, yes.

MR. BEEBE: Can I read a little from this?

THE COURT: Yes.

Q It is from Mr. Cunningham. He was a vice president of the exchange, was he not, at that point?

A Executive vice president.

Q To the chairman of the Securities and Exchange Commission, October 30, 1969. The attachment is headed McDonnell & Company. First heading, basic first problem.

"Declining volume and substantial expenses from a new computer system which did not work caused operating losses which resulted in capital violation."

Then under background describes the proposed new computer system requiring more sophisticated hardware in April 1968.

"During 1968," it says on the top of page 2, "The corporation incurred additional expenses of some $1 million incidental to the undertaking of conversion to the system with result in impact on earnings and

hence on capital."

Page 3, "In retrospect it is apparent that the death of the firm's vice president in mid-1968 and the illness and subsequent death in 1969 of its operations vice president created a serious lack of decision making in the firm."

The executive vice president refers to -- do you know who that was, sir?

A Sean McDonnell.

Q Page 4, "While the corporation had anticipated that the loss for September would approximate $725,000, it has been reported that the actual September loss was approximately $1,500,000." This is 1969.

Do you have a copy of Exhibit 86, sir, the special membership bulletin there?

A Yes.

Q That's the tag copy.

A Yes..

Q This is Mr. Haack's memorandum.

Sir, on the top of page 2 when describing McDonnell, Dempsey Tegler and Blair, it said that they had a total of 165 customer accounts.

How many of those were McDonnell's?

A You are not accurate.

Q 165,000.

A Okay.

Q How many were McDonnell's?

A I don't know what figure we were using for McDonnell in that total. At various times they had different numbers of accounts. I don't know what -- which one we were using in that instance.

Q Looking down the page where it talks about how this had been a scaled down approach and it shows accounts on 165,000 to 90,500.

Do you see that?

A Yes.

Q My question is: Did the 165,000 represent the high point of the number of accounts that they had?

A That is probable.

Q Turning, sir, to the second page of the exchange report that is attached, under method of regulations, paragraph 1, it says:

"Restrictions. The policy of restrictions on the business of firms and operational trouble begun in April 1968 was unprecedented. It was the key weapon in attacking the paperwork problem. The scope of 21 possible restrictions ranged from bans on advertising and promotional activity to fixed limits on the number of

orders that could be written both for public customers and firm accounts. Most severe were restrictions barring a firm from accepting any order which would bring in new customer funds or make it necessary to deliver securities to the firm."

Do you see that, sir? My question is: Were any of those 21 possible restrictions of the kind that were named there or any other kind imposed on McDonnell & Company between the time when the April restrictions were lifted in 1968 and January 15, 1969?

A No.

Q Turning to the last page, "During these three crisis years the exchange has used a variety of new rules and surveillance methods tempered by the practical business judgment of its staff and governing board in an attempt to cope with the problems that resulted from the historical volume upsurge in 1968, '69 and the relentless profits squeeze in the past year."

Sir, what role did practical business judgment have in the exchange's application of its regulatory function?

A Numerous.

Q Would you be specific, please, sir.

A Well, we mentioned several here in this trial.

For example, the -- whether or not a particular tax refund should be given capital credit, whether or not a particular kind of trade date basis should be given credit in the arbitrage matter we have discussed, things of that kind.

Q Was this practical business judgment application communicated to the plaintiffs before they made their investment?

MR. BROOKS: I object, your Honor.

THE COURT: Yes, sustained as to form.

Q Was there any communication to the plaintiffs concerning those steps taken by the exchange before they made their investment?

A As to what others did, I have no knowledge. As to the exchange, I have already said that we had no communication with them.

Q Turning back, sir, to the phrase or perhaps -- you don't even have to turn to it --

A What page?

Q The third page of the attachment to that exhibit about the exchange finding itself facing situations where normal application of the rules would have meant possible loss for thousands.

MR. BROOKS: I object. It mischaracterizes

the language.

MR. BEEBE: I have to key into the language.

THE COURT: The bottom three lines on that page. Put your question.

Q My question is: Was that reference to not having normal application of the rules in those situations the same thing as the practical business judgment that is referred to on the last page?

A No.

MR. BROOKS: I object to the question, your Honor. It says not having normal application inthe rules. The language reads what normal application of the rules could have meant, it doesn't say there was in this document.

THE COURT: To the extent that it is applicable, the witness said the answer to that question is no. I'll leave it stand.

Q Going, sir, to the top of the second page of the exhibit where it talks about allowing a few major member firms to continue in business despite critical paperwork and capital problems.

Could the exchange under its rules have put McDonnell & Company out of business at the tim eof the critical paperwork and capital problems that were

referred to there first arose?

A It's a very complex question. I think my answer is in my opinion, no.

Q Can you explain what the statement meant that the exchange -- what the question meant, "Question often asked is why did the exchange allow" -- the word is allow -- "a few major member firms to continue in business?

MR. BROOKS: Where are you reading from?

MR. BEEBE: Top of the page.

THE COURT: Page 2 of the entire exhibit, Mr. Brooks.

Q Can you answer that question, sir?

A I haven't heard a question.

THE COURT: Put it again.

MR. BEEBE: Certainly.

Q The sentence on top of the page reads or starts, "Question often asked is why did the exchange allow a few major member firmsto continue in business."

My question is, can you explain what that meant?

MR. BROOKS: I object, your Honor. If he's asking him to explain why someone asked the question, I don't think the iwtness or whoever wrote these first

few pages is competent to explain why those questions were asked by some other people.

MR. BEEBE: I believe that the witness testified at transcript page 2056 that he --

THE COURT: No, please.

MR. BEEBE: -- he participated.

THE COURT: Let's not argue these colloquies to the jury.

What is the page number?

MR. BEEBE: 2056. I don't mean it in some other case, I mean in this case.

MR. BROOKS: I agree the witness testified that he prepared all but the first two pages.

THE COURT: I think he reviewed the first two pages after they had been prepared.

MR. BEEBE: For correctness.

MR. BROOKS: Looking at the language Mr. Beebe is now focusing, it reads, a question often asked is why the exchange did a certain thing. All that tells us is that they have had some inquiries from others.

THE COURT: I see what you aer saying. I sustain the objection.

Q The last question, the last statement in that

same paragraph while you have it in front of you, is "In each case the exchange allowed continued operation under increasing regulation pending a scaling down of business and reduction of paperwork backlogs to manageable proportion."

My question is: What was meant by that in terms of whether or not the exchange could put the company out of business due to the very critical paperwork and capital problems that are referred to in that sentence?

MR. BROOKS: I object to the form of the question.

THE COURT: In the interests of getting on, let's see what Mr. Bishop can say. Can you answer?

THE WITNESS: Since it isn't put in the context of McDonnell & Company, I don't think it's a very answerable question.

MR. BEEBE: Your Honor, I submit that's not a very fair reply in that context. I am definitely talking about McDonell & Compan y and so is all those sentences.

THE COURT: I am going to sustain the objection to the form of the question.

Do you want to put it again and build a foundation, please?

MR. BEEBE: Very well.

Q I'm going to approach it a little differently. Were the critical paperwork and capital problems that are referred to in there with regard to McDonnell & Company, did those amount to violations of the exchange's rules?

A At some times. At other times no.

Q Did the exchange issue any public announcement that it had decided to allow McDonnell & Company to stay in business despite its critical paperwork and capital problems?

MR. BROOKS: I object.

THE COURT: Yes. What is the purpose of this tangential question?

MR. BEEBE: I submit, sir, it's right on the point of when they made this decision, whether they communicated it to specifically our clients or in any --

THE COURT: You haven't established the time of it. You haven't established any time as to it except to the extent that he says that the non-normal application of rules began in January of 1970. That's the only time it's been mentioned.

MR. BEEBE: I believe the memo itself goes back to --

THE COURT: I know. We are talking about a specific paragraph now.

MR. BEEBE: The specific paragraphs also did not mention time, sir.

THE COURT: Why don't you ask him.

MR. BEEBE: All right.

Q Within the time frame involved in this suit, sir, at any time between, say, 1968, the beginning of '68 to the time McDonnell went under, March 13, 1970, did the exchange issue any public announcement to the effect of that first paragraph which is that the exchange allowed McDonnell & Company to continue in operation despite critical paperwork and capital problems?

MR. BROOKS: I object again.

THE COURT: Sustained. I don't see that is getting where you want to go.

MR. BEEBE: I want to know if he told our clients they had done this.

THE COURT: Why don't you ascertain, A, what they are doing and then ask whether he told your clients. He said now that some of the paperwork was a violation, some wasn't, some of the capital problems was a violation, some watn't. We have nothing pinned down, and then you ask if there was a public announcement

MR. BEEBE: Or an announcement. I will withdraw the public announcement and just say an announcement to our clients.

THE COURT: You have to get some time established here and tie it up specifically to whether these were violations or were not violations so we have something to work with.

MR. BEEBE: Let me do it differently because I think I know what the answer is.

Q Looking at Exhibit 86, was there any prior announcement before the date of this exhibit of the contents of that?

MR. BROOKS: I object, your Honor.

THE COURT: Yes, sustained.

Q Was McDonnell & Company in late 1968, early 1969, up to January 30, 1969 able to settle its transactions in the ordinary course of business?

A Yes.

Q Did there come a time when it was unable to settle its transactions?

A I don't believe so, until after they were put into liquidation.

Q Is it your position, sir, that the new capital which came in at the end of January and early

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February 1969 took McDonnell & Company out of capital violation?

MR. BROOKS: I object to the form of the question, your Honor.

THE COURT: Do you understand that the fact that the new capital came in at that time remedied the capital violations situation?

THE WITNESS: We b elieved it did at the time.

Q What is your belief now? Did it?

A I'm not sure. I remember that a later examiner's report cast doubt on a period somewhat after the audit date. I'm not sure whether it ran up to the date you are asking about or not.

Q Do you know of any exchange analysis that showed McDonnell & Company to be under even the 2000 per cent limit at any time from October 31, 1968 to July 31, 1969? I'm talking about as of dates. You understand what I mean?

MR. BROOKS: I object to the form of the question.

THE COURT: Overruled. Go ahead.

A I don't think the question was complete. Could you read it back and find out? I don't think we

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had a question.

THE COURT: Would you read it back.

(Question read)

A I do understand what you mean.

Q Yes. What about the earlier part of the question? Do you know of any exchange analysis?

A I don't remember them.

Q I show you copies of the analyses, the top one happens to be the latest, that have been marked in evidence. Particularly I'm giving you in chronological order Exhibits 37AA, 39, 74, 20, 22, 23B and EEE. The character memorandum may be in there, too, which is Exhibit 83.

MR. BROOKS: Your Honor, don't all these exhibits speak for themselves? The question was did Mr. Bishop know of any analysis which showed a certain thing.

MR. BEEBE: I think these may help him. I would also like to show him Exhibit 107 for identification which may help remind him of the answer to that question.

MR. BROOKS: I object to 107 being used for any purpose.

MR. BEEBE: I would like to know what the

objection is.

MR. BROOKS: It appears to be a document prepared by yourself, Mr. Beebe.

MR. BEEBE: It was prepared under my direction.

THE COURT: At this point we'll not use 107.

slh 1 Bishop-cross

Q Now, the pending question -- perhaps I will pose it again to give you some direction -- do those exhibits remind you that, in fact, there were no computations by the exchange between those dates that showed McDonnell & Company to be in compliance with the net capital rule?

MR. BROOKS: I object to that.

MR. BEEBE: I believe it is perfectly proper.

THE COURT: Let me hear that question Mr. Reporter.

(Question read.)

THE COURT: You may answer.

A No.

Q No in the sense that they don't remind you?

A Correct.

Q Do you know, as you sit here, of any computation that did show McDonnell & Company in compliance between those dates?

A I have already answered that question with a no.

MR. BEEBE: Now I would offer, your Honor, Exhibit 107 for the sole purpose of having an aid, as our chart is, showing from the trial exhibits what it shows.

MR. BROOKS: I object.

MR. BEEBE: These are all exhibits that are in evidence, not anything else.

THE COURT: I am going to withhold ruling on this for a day or two until Mr. Brooks at least has had a chance to check it out to see if it represents what you contend it does.

MR. BEEBE: I can give him a spare copy, then, to mark up.

BY MR. BEEBE:

Q Did McDonnell & Company have a profit for the year 1968?

A That was my understanding.

Q I show you Exhibit 98 which your counsel furnished to us last Thursday. Was that the basis of your understanding? It was only marked for identification at that point.

A That is consistent with my understanding.

MR. BEEBE: I offer 98 in evidence now.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 98 received in evidence.)

Q The profit here --

THE COURT: Why don't you read it to the jury?

MR. BEEBE: I believe the profit figure shown here is 461,684 for the year 1968 before taxes --

MR. BROOKS: No, your Honor. It is after taxes.

MR. BEEBE: Before and after is the same for 1968.

MR. BROOKS: The bottom line is the same.

MR. BEEBE: Before and after are both the same thing as far as taxes are concerned.

BY MR. BEEBE:

Q Now I show you a document which is part of Exhibit 16 in evidence and ask you what that shows.

Am I correct that that shows that before taxes the profit for the first eight months of 1968 is $1,595,862?

A That's what the schedule says, after taxes, $950,000.

Q And before taxes the figure is mentioned.

Now, did McDonnell & Company -- does that remind you -- this is some testimony I asked you about last Thursday -- does that remind you that McDonnell & Company had a loss of $1,134,178 before taxes in the last four months of 1968?

A No, it does not remind me of it.

MR. BEEBE: Could I have a brief moment at the side bar before I pursue this? This is just about my last line of questioning.

THE COURT: Yes.

(At the side bar.)

MR. BEEBE: There is another case called Mark v. McDonnell & Company. The exchange was in this, I don't

know how far in, but they were in it for a long time. These were answers served by McDonnell & Company. It shows the monthly losses for the months of September through December and also January and March.

Those figures, according to our computation, add up to the same after tax figures as are in the documents we have there.

I would like to introduce this in evidence, but I want to do it in a delicate way.

THE COURT: Well, it can go in against McDonnell & Company, but how does it go in against the exchange?

MR. BEEBE: The reason I was going to do it with this witness is I was going to ask him questions along this line:

Were you aware of Mark?

Did you go out and testify in that case?

Were you following them?

Did you receive this claim at one point?

Is the information accurate?

MR. BROOKS: The answers will be no. He had nothing to do with Mark. We were named as a defendant but we did not participate.

In Mark, your Honor, the plaintiff, Mr. Mark, got a motion for summary judgment granted against McDonnell &

Company for their violation of the State of Illinois Blue Sky Law, selling Mr. Mark some common stock without complying with the State of Illinois Blue Sky Law.

MR. BEEBE: I thought Mr. Bishop or Mr. Brooks might have received this document at that point and would show all these losses I have been trying to show.

THE COURT: Apparently not.

MR. BEEBE: Apparently not.

MR. BROOKS: I can tell you, if it reached Milbank Tweed it certainly never went to Mr. Bishop. There was no reason todo that.

MR. BEEBE: I guess I will just have to put it in against McDonnell & Company.

MR. BROOKS: I don't know why you are putting it in. There is an exhibit already in evidence compared to this exhibit which shows the same thing.

THE COURT: Does it make any difference?

MR. BEEBE: I will tell you what I will do. I will just offer it in evidence against McDonnell & Company only.

MR. STEIN: I think there has been no foundation for the document, and there is no testimony showing that anyone in this room can testify to the sponsorship of the document.

MR. BROOKS: This is not even a certified copy.

MR. BEEBE: I came up here because I wanted to do it in a delicate way.

THE COURT: Are we arguing about anything fundamental?

MR. BEEBE: I think that question applies to both sides.

MR. STEIN: What is the offer of proof?

MR. BEEBE: The offer of proof is that it shows the loss against the company, pure and simple.

Let me just put it in now just to get it over with.

MR. BROOKS: No, I object to your putting it in now. It is technical, yes.

MR. BEEBE: All right, then I will put it in in my rebuttal case, or my first exhibit on the rebuttal case.

THE COURT: All right.

(End of side bar discussion.)

BY MR. BEEBE:

Q Did McDonnell & Company materially violate the provisions of Rule 325 during the period of 1968 to 1970?

MR. BROOKS: I object.

THE COURT: Sustained as to form.

Q Did McDonnell & Company violate the provisions of that rule during the period 1968 to 1970?

A Yes.

Q Excuse me?

A Yes -- not the whole period just at times.

Q Did it violate books and records rules of the stock exchange in that period?

A At times, yes.

MR. BEEBE: Subject to any pending ruling I have no further cross of this witness.

THE COURT: All right.

MR. BROOKS: Just two questions your Honor.

REDIRECT EXAMINATION

BY MR. BROOKS:

Q Mr. Bishop, I show you Exhibit 83 which is the charge memorandum.

Mr. Bishop, was it the practice of the exchange when it prepared trial memoranda such as this to include all violations that the exchange thought could be proved against a member firm?

A Yes.

MR. BEEBE: Objection.

THE COURT: No, overruled.

Q Would you look at Schedule D, sir, where there is a listing of various dates on which McDonnell & Company was charged with having violated the capital rule.

Would the practice of the exchange or under the practice of the exchange would the inference be from the violations and the dates listed, or dates that are not listed, the exchange could not prove a capital violation against McDonnell & Co.?

A Yes --

MR. BEEBE: Objection.

THE COURT: Yes, sustain the objection. Strike the answer.

MR. BEEBE: Could we ask that the witness just give me a third of a moment or two to make an objection, if I have one?

THE COURT: Yes.

If you see Mr. Beebe rising, don't answer, Mr. Bishop

BY MR. BROOKS:

Q Mr. Bishop, after reviewing Schedule E can you tell me whether McDonnell & Company were in compliance with the exchange's capital rule during the period October, 1968, through March, 1970, at any time?

A It would appear that they were in compliance between the end of January, 1969, and June, 1969, at least.

I can't be definitive about the rest of the period.

Q Mr. Bishop, we have heard testimony about New York Stock Exchange special trust fund that was available at about the time McDonnell & Company went into liquidation to assist customers of McDonnell & Company to recover their money and securities that were in the firm of McDonnell & Company at the time they went into liquidation.

Is that trust fund still available to help customers if a member firm should have the same fate today?

MR. BEEBE: Objection to relevance, timely aspects. I don't know what it pertains to as far as this case is concerned.

THE COURT: Well, if it is only relevance I will overrule it.

Can you give me some other basis?

MR. BEEBE: The time --

THE COURT: It calls for a yes or no?

MR. BROOKS: Yes, it does.

THE COURT: Overruled if it is only relevance.

Do you have a trust fund?

A No, not as an active entity. It has been replaced.

Q Is the protective function performed by anybody else today?

MR. BEEBE: Objection. Now really --

THE COURT: Yes, sustained.

MR. BROOKS: No further questions.

RECROSS EXAMINATION

BY MR. BEEBE:

Q I have one line of questioning on Exhibit 83, the charge memo.

Do you have that in front of you?

A Yes.

Q Will you tell to the last page. Does that have your signature and T. Murray McDonnell's signature on it?

A It does.

Q Did T. Murray McDonnell consent --

MR. BROOKS: Your Honor, I object. This hasn't anything to do with the line--

THE COURT: Yes, sustained.

MR. BEEBE: I believe it has to do with the question of whether these are just mere charges they threw together or whether they had some meaning. That was his first line of questioning on redirect: What was the nature of this document? And that is what I was pointing out, that this was a final document.

THE COURT: I don't see how this particular answer to the question will get you what you want.

MR. BEEBE: It was agreed to.

THE COURT: So?

MR. BEEBE: So it was just something that they made charges about. The other side, the recipient of it, finally --

THE COURT: Sustained.

Q Now you were asked about Exhibit D, and I would like you to look at all of that exhibit.

Am I correct that there is no use of a figure below 2,000 per cent?

MR. BROOKS: Objection your Honor. The exhibit speaks for itself.

MR. BEEBE: Then I can read all the numbers in if necessary. I just want to make sure I am right.

THE COURT: Why don't you save that reading for summation if it is just a question of reading.

MR. BEEBE: We have no further questions on recross of Mr. Bishop.

We do have the reading of Mr. Stock's deposition which is still part of our reply.

Unless Mr. Brooks has some more witnesses that should be the end of the defendant's case, and I would have to put in Mr. Stock's testimony as my cross-examination--

THE COURT: You can put that in during Mr. Brooks' case.

MR. BEEBE: Yes, which is right now.

THE COURT: All right, go ahead.

MR. BROOKS: No further questions of Mr. Bishop.

(Witness excused.)

MR. BEEBE: I believe the jury is familiar with this procedure. This is the cross-examination of Mr. Stock who was examined by having questions from his deposition read in earlier, and now these are other questions and answers from the deposition. Mr. Stock, I believe, is deceased.

Starting on page 14:

"Q Was there a ratio or percentage where when passed the New York Stock Exchange became concerned?

"A Yes."

MR. BROOKS: Your Honor, I object. This has nothing to do with the direct testimony of Mr. Stock's deposition which we read in. If anything, it is part of plaintiffs' case, and the same rules apply.

THE COURT: Mr. Beebe, isn't that so? Are you reading matters that do not explain or bear upon things read by Mr. Brooks?

MR. BEEBE: I have to make a little confession here. I didn't prepare the cross here of Mr. Stock, and I asked Mr. Marc Adelsohn, who is also part of our legal team

s1h13

here, to give us some light on it.

(Addressing Mr. Adelsohn) Does it direct itself directly to the direct or are we going into new areas, in which case I will do it as part of our rebuttal?

MR. ADELSOHN: We will save it for rebuttal.

MR. BEEBE: Perhaps, so we don't do a piece here and a piece on rebuttal, can I do the whole thing at once?

THE COURT:Yes.

Mr. Brooks, do you have any further witnesses?

MR. BROOKS: No further witnesses, your Honor.

THE COURT: All right.

(Addressing Mr. Beebe) Do you have a rebuttal case?

MR. BEEBE: Yes, sir, unless Mr. Stein has something.

THE COURT: Mr. Stein?

MR. STEIN: Your Honor, the receiver's case was concluded.

THE COURT: Yes.

MR. BEEBE: Okay, then we will go to Mr. Stock.

THE COURT: This, ladies and gentlemen, is the rebuttal case offered on behalf of the plaintiff, the stock exchange having rested its case.

MR. BEEBE: Page 14:

s1h14 "Stock

"Q Was there a ratio of percentage where when passed the New York Stock Exchange became concerned?

"A Yes.

"Q Can you tell me what that ratio was?

"A 1,500.

"Q 1,500 per cent?

"A Yes.

"Q What action aside from normal action was taken by the New York Stock Exchange when a member firm passed that 1,500 per cent figure?

"A The firm would be contacted and directed to take appropriate steps to reduce their ratio below that figure."

MR. BEEBE: Page 29.

"Q Do you recall during the period of December 1968, which you told me is the first month you worked at the New York Stock Exchange through March of 1970 recommending suspension of a member firm for violation of rule 325?

"A No.

"Q Do you know of any situation where a member firm was disciplined by the New York Stock Exchange for violation of rule 325 during this time period?

"A YEs.

"Q Can you tell me the name and the instance?

"A There were several instances. Well, I recall -- put it this way: I would estimate that there may have been 15 or so cases brought during that period for violation of rule 325. I don't recall the names of all the firms. I can think of a few names at the pertinent time.

"Q Can you give me those names?

"A Jeffries & Company, Raucher, Pierce Corporation. I think there was Robinson & Company.

"Those are the names that come tomind at the moment.

"Q Can you tell me what discipline was imposed upon these firms?

"A It varied in each case, based upon the board's determination of the action that was appropriate.

"Q What type of discipline was imposed? Are we talking about a monetary fine, or are we talking --

"A In certain cases there were monetary fines. I would say in probably every instance there was a censure."

MR. BEEBE: Turning to page 89:

"Q When do you first recall participating in the drafting of the charge memorandum against McDonnell & Company, if you did participate in such drafting?

"A My initial participation in the drafting would have been to instruct my staff to start such drafting.

"Q Do you recall when you instructed your staff to start such drafting?

"A Not specifically.

"Q Can you approximate it?

"A I would think some time in the first half of 1969.

"Q Do you recall, when you asked your staff to start drafting the charge memorandum, whether

the charge memorandum was based on a violation or violations of Rule 325, or whether it included various other violations of rules of the New York Stock Exchange?

"A As I recall" --

MR. BROOKS: I object, your Honor. At that point in the transcript there was an objection to the form of the question. I renew that objection now.

MR. BEEBE: I don't find the form bad, on top of which he did suggest he go ahead and answer it.

MR. BROOKS: That was to assist counsel in his discovery, your Honor, but maintaining my objections to form as is required.

MR. BEEBE: That is the last question.

THE COURT: I will overrule the objection anyway.

"Q Do you recall, when you asked your staff to start drafting the charge memorandum, whether the charge memorandum was based on a violation or violations of Rule 325, or whethre it included various other violations of rules of the New York Stock Exchange?

"A As I recall, the charge memorandum was to include violations of rules other than --

of rules, including Rule 325."

MR. BROOKS: Is it appropriate at this time, your Honor, to put in one question and one answer of Mr. Stock's testimony as if redirect?

MR. BEEBE: I have no objection.

THE COURT: Why don'tyou read it.

MR. BROOKS: Page 14, Mr. Beebe read a passage in the middle of the page. There'a a question and answer at the end.

May I read Mr. Beebe's passage and then tack on the question and answer that follows?

THE COURT: Okay.

BY MR. BROOKS:

"Q Was there a ratio or percentage where, when passed, the New York STock Exchange became concerned?

"A Yes.

"Q Can you tell me what that ratio was?

"A 1500.

"Q 1500 per cent?

"A Yes.

"Q What action, aside from the normal action, was taken by the New York Stock Exchange when a member firm passed that 1500 per cent figure?

"A The firm would be contacted and directed to take appropriate steps to reduce their ratio below that figure."

Mr. Beebe stopped there and I will continue.

"Q Do you recall whether the firm of McDonnell & Company was contacted by you directly as to their capital ratio, in the year 1969?

"A Yes, they were."

MR. BEEBE: May I just put in the next question and answer?

THE COURT: Go ahead.

BY MR. BEEBE:

"Q Do you recall the first instance when you contacted them?

"A Not specifically."

MR. BEEBE: Could we call now Mr. Spies.

R O B E R T A. S P I E S, recalled as a witness by the plaintiffs, having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BEEBE:

Q Let me put in front of you Exhibits 43 and 43A for identification --

MR. BROOKS: Your Honor, part of the assignment of the exchange counsel over the noon hour was to come up with the original of Exhibit 43A, which we have done. So I offer that to Mr. Beebe so that he may use the actual document.

THE COURT: Very good.

MR. BEEBE: May I just have a minute to look at this?

THE COURT: Surely.

(Pause)

Q I will give you something to look at, Mr. Spies, 25 that is in evidence and 43 for identification (handing).

MR. BROOKS: Your Honor, I understand the purpose of calling Mr. Spies was simply to identify 43 and 43A.

MR. BEEBE: That's exactly what I'm doing.

MR. BROOKS: I object to 25 insofar as it does not relate --

MR. BEEBE: I'm using it as part of the identification process solely. If I stray afield, I'm sure that will be an opportunity to try and do something.

May I suggest for everyone's convenience that we substitute your 43A. In other words, the thing

you have just given, take the tag copy off.

MR. BROOKS: I have no objection to that. I would like pe. ission to substitute a Xerox so we can get back the original record for the exchange's file.

THE COURT: Very good.

Q Here is 43A which has been marked for identification (handing).

Starting with 43, sir, which is apparently a letter from yourself to Mr. McDonnell & Company dated March 18, 1969. At that time in 1969 were you dealing with McDonnell & Company concerning its net capital ratio?

A It appears I was the one that answered this letter which answered the spec ial financial questionnaire of January 30, 1969.

Q Could you remind the jury and perhaps myself, too, what role you played at that time, what your function was with regard to McDonnell & Company?

A I was in t he finance division of the exchange and was manager of it for some period of the time. The division was responsible for the administration of the capital rule.

Q Was it part of your function at that point to make an analysis of McDonnell's financial questionnaire?

A No, it was not.

Q Could you explain what Exhibit 43 was, the letter from yourself --

A 43 is a letter which was based on the analysis of the financial questionnaire which was furnished to us by the examiner's division.

Q That was a letter from yourself to McDonnell & Company?

A Yes, it was.

MR. BEEBE: I offer that in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 43 was received in evidence)

Q Could you explain what 43A is, sir?

A 43A appears to be schedules which are submitted in connection with the answers to a financial questionnaire.

Q Does the red stamp on the front there indicate that it was received by the stock exchange on or about the date it has there?

A It indicates it was received by the chief examiners on February 28, 1969.

Q Would that be received from McDonnell & Company?

A I don't know.

Q In the normal course of things would that be a document that McDonnell & Company would submit?

A Yes, it would be.

MR. BEEBE: I offer thatin evidence.

MR. BROOKS: I object, your Honor. I don't think it's been properly identified. It was not a deposition exhibit and it was not the subject of a demand to admit. I think all we know now that it bears the chief examiner's stamp and that Mr. Spies has brought it up here with him from the files of the exchange.

MR. BEEBE: I thought that was the main problem this morning, was that my document, they raised some questions as to where did it come from. We have now solves that problem without having to call any more witnesses just to authenticate that they received it. I think we have got enough basis now with that red stamp.

THE COURT: Without getting into the truth or falsity of the information contained in it, I would admit it as being a document that was received on the various dates that the stamps indicate throughout, which are different in certain cases. Certain pages came in at different times. This is not being received, ladies and gentlemen, for the truth of what it contains. There are figures in here. It's not proof of that. It's

only proof of the fact that the stock exchange received this batch of papers.

(Plaintiffs' Exhibit 43A was received in evidence)

Q Let me ask you, sir: 43, your letter of March 18, which is now in evidence, says "Acknowledgement is made of your coeporation's response to the special financial questionnaire of January 30, 1969."

Is your letter referring to 43A?

MR. BROOKS: Your Honor, I object. The witness testified he would not see 43A. The examiner would see it, provide Mr. Spies --

THE COURT: Let's find that out from the witness. Do you know?

A Do you want to repeat the question?

THE COURT: Mr. Spies, take that piece of paper in front of you. 43and the information in there, did that come from 43A that you hold in your right hand?

A No, it did not.

Q When your 43 referred to the response to the special financial questionnaire, do you know as you sit here what your letter was referring to?

A It was referring to a white sheet, as we call it, which is prepared by the examiners division,

was prepared by the examiners division and sent down to the finance division.

Q Maybe I haven't made myself clear.

The first paragraph of your letter says, "Acknowledgement is made of your corporation's response." Your letter is addressed to McDonnell & Company.

Are you holding that response in your right hand?

A Our letter would acknowledge the response that was based on the white sheet. The white sheet was prepared from a response from McDonnell & Company.

Q My question is --

A We assume that when we -- when we received the white sheet, that they had the response to the financial questionnaire.

Q My question is: Is the document in your right hand that response?

A The dates are similar.

Q They areidentical, are they not?

A Right.

MR. BEEBE: I offer 43A against McDonnell & Company for the facts contained in there.

MR. STEIN: I haven't heard any testimony that establishes that this document came from McDonnell &

Company. I only heard the witness say that he received it.

MR. BEEBE: I think that by the response, 43, the document 43A with the heading McDonnell & Company, there's no other source possible. I know it.

THE COURT: You are going to have problems with this. McDonnell & Company, you can read this as to the facts. What facts do you want to urge against McDonnell & Company from this, Mr. Beebe? You can simplify this.

MR. BEEBE: May I read from this?

THE COURT: No. What are you offering?

MR. BEEBE: If you will address schedule 10, page 1, schedule 10, page 3 --

THE COURT: Those two pages?

MR. BEEBE: You will see totals given for certain accounts.

THE COURT: Those are the pages?

MR. BEEBE: Andif you take the analysis in Exhibit 43 --

THE COURT: We are talking about 43A now. What are you offering 43A against McDonnell & Company, what facts?

MR. BEEBE: Those facts on those two pages.

THE COURT: 1 and 3 are in evidence against McDonnell & Company for the truth of the pages.

MR. STEIN: Schedule 10?

THE COURT: Schedule 10.

MR. BEEBE: There is one other. Now that I'm being asked -- do you still have it? Pages 6 and 7 of the answers themselves refer to federal income tax claims.

THE COURT: How does that bear on McDonnell?

MR. BEEBE: McDonnell income tax claims that they were taking or trying to take --

THE COURT: That only goes to the stock exchange.

MR. BEEBE: As far as facts are concerned, that's right. As far as what the stock exchange did in reaction to X information, that's right.

No further questions of this witness.

THECOURT: All right. Mr. Spies, you may step down.

MR. BROOKS: I have some questions.

THE COURT: I'm sorry.

CROSS EXAMINATION

BY MR. BROOKS:

Q Mr. Spies, on Exhibit 43A there, sir, if I

might borrow it. Schedule 10, page 1, next to the indication Mrs. Margaret McDonnell Murphy, under agreement dated January 30, 1969, had a certain subordinated account. Next to it there appears in pencil the words "Approved 3-6-69."

Can you tell me if that's your handwriting?

A No, it is not.

Q When you wrote your letter, which was Exchange Exhibit 43 -- do you have a copy of 43, sir?

A Yes, I do.

Q Did you know whether Mrs. Murphy's subordinated account was or was not being treated as part of the capital of McDonnell & Company?

A I don't know.

Q If I told you, sir, that her subordination agreement was dated February 4, 1969, would that assist you in answering that last question?

A No, not really.

Q Did McDonnell & Company make any reply to your letter of March 18, which is Exhibit 43?

A I would presume they did.

Q Do you recall whether they disputed the analysis you set forth in your letter of March 18, which is Exhibit 43?

A I would have to review the files.

Q Let me show you a letter dated March 28, 1969 addressed to yourself, purportedly signed by Thomas A. McKay, and ask you if that letter refreshes your recollection (handing).

MR. BEEBE: Could I speed things along by saying if this letter is being offered, I have no objection.

MR. BROOKS: It hasn't been offered yet.

A It would appear that this letter does respond to my letter of March 18, yes.

Q Does that refresh your recollection as to whether McDonnell & Company disputed your analysis contained in Exhibit 43?

A Only as I read it, the ltter certainly does dispute the analysis that we have, yes.

Q Aside from the letter, you do not have an independent recollection?

A No.

MR. BROOKS: I offer the letter now and I accept Mr. Beebe's agreement that it should come in.

THE COURT: Received.

(Defendant New York Stock Exchange Exhibit XXX was received in evidence)

MR. BROOKS: I would like to read from a portion on page 2, your Honor, I would like to --

THE COURT: Are you going to be much longer?

MR. BROOKS: One minute.

THE COURT: All right.

MR. BROOKS: On page 2 Mr. McKay says -- this is a letter dated March 28, 1969 addressed to Mr. Spies signed by Thomas A. McKay at McDonnell & Company. Mr. Spies begins on page 1, "On March 18 you advised us of your analysis of our response to the financial questionnaire as of January 30, 1969. We submit the following comments regarding the analysis."

Skipping to page 2:

"Your analysis revised for the foregoing items would be as follows." Then I'm skipping some intermediate figures.

The bottom line, "Capital ratio, 1930 per cent."

No further questions of Mr. Spies.

REDIRECT EXAMINATION BY

MR. BEEBE:

Q One question on the letter that's been put in. A little higher up on the page --

A I don't have a copy of the letter. I got it

now.

Q This is from Mr. McKay to you. "Your computation of net capital included a deduction of $700,000 for federal tax claims. Based on our previous discussion it is our understanding that this was an admissible asset."

Mr. Spies, to what discussion, if you know, was Mr. McKay referring?

A I have no idea.

MR. BEEBE: No further questions of Mrs. Spies.

THE COURT: You may step down, sir.

(Witness excused)

THE COURT: We will stand in recess, ladies and gentlemen.

Will counsel please stay a moment.

(Jury absent)

THE COURT: Gentlemen, I have read and re-read 104 and 105 for identification, which are the commissions and letters of April '70 and November '70. They give me a little trouble given the request that the exchange wants me to give having to do with supervisory oversight. I'm obviously troubled by the fact that the first of them, April '70, takes a blast at

"improper practices which have crept into the application of the exchange's net capital rule."

While I read through 104, I don't see that any of the things that they are criticizing figure in this case.

Am I correct in that?

MR. BROOKS: Yes, your Honor, you are.

MR. BEEBE: Excuse me. 104 --

THE COURT: April 29, 1970.

MR. BEEBE: I would say it does bear on the issues in this case very much.

THE COURT: I haven't heard any testimony -- maybe one or two of them figure in some way that I have missed as the testimony has gone along because you gentlemen are familiar with this case from years of experience, this is hardly the commission saying to the exchange you have been doing a great job, fellows, we have been watching how you have been going, you have been acting within your discretionary limits. I do not intend to admit these exhibits.

On the other hand, I'm wondering whether a way out of the problem is if counsel could stipulate that we withdraw the oversight issue from the case and I won't charge that?

MR. BROOKS: Your Honor--

THE COURT: I'm troubled with the fact that it doesn't seem wholly fair to charge the jury that the commission's failure to act is in some way a seal of approval of good housing. Although I'm frank to say I don't see quite that the matters that are complained of in these letters are the same ones we are dealing with. Nevertheless, the whole tenor of them is one of criticism.

I'm also not quite clear that the motives of the commission writing this letter at this time were perhaps unmixed.

MR. BROOKS: Your Honor, the instruction that we wish on oversight is based solely on the evidence that's gone into this case with respect to the SEC's examination of the affairs of McDonnell & Company. I don't see that these letters adversely affect or even refer to what the SEC knew about McDonnell & Company. We have had testimony about an SEC disciplinary proceeding in and about April of 1970 against T. Murray McDonnell and I don't see that the instruction that we want solely as it relates to what the SEC knew the exchange was doing as to McDonnell & Company is in any way referred to or negated by these general letters about who's going to take

responsibility when we have to go up to capitol hill. Also, these letters were certainly responded to by the exchange in the same general kind of way.

I would urge that the instruction that we seek is not all related to the general kind of chatter that is going on and reflected in exhibits 104 and 105.

THE COURT: Mr. Beebe, what say you to this?

MR. BEEBE: I say he wants the best of both worlds. Mr. Brooks wants both to have the oversight issue on his side and not to give me a chance to meet it on my side.

These exhibits, and they are only part of a number that we have seen of reports that Congress and at the SEC level were very highly crititcal of what the exchange did during that era right on, application of the net capital rule and the operations rules -- I believe as we saw this morning with a number of the exhibits that I offered, that there was a very strong barrage, an increasing barrage of criticism from the SEC as they discovered how they had been misled in 1968 and 1969 about how bad conditions were. That accounts for the fact, your Honor, that some reports were sent by the company down to theSEC in 1968 and '69 or at least '69, as they introduced them in evidence, and the SEC didn't act.

Two reasons why it didn't as far as we can tell from the records and evidence that I tried to introduce.

Number one, the SEC didn't know the whole story.

Number two, perhaps the SEC itself was to complacent, which is the point you are saying and, therefore, wrote these letters later on. But these letters later on I think are perfectly valid oversight letters by the SEC stating what its position based on all the facts was. I don't think if they are going to get into the SEC's motivation for inaction, which is really basically as to McDonnell, I shouldn't be able to get into the SEC's action apart from what it was that -- if one tries to read between the lines, which is very hard to do, in April and November, as to why the SEC did or didn't take a strong stand at that point. I just want to fairly meet this issue and be given a chance to do so.

THE COURT: If I were to say to you that I would not charge on that, would that satisfy you?

MR. BEEBE: I guess my problem is, sir, that in the summaries -- if I hear summary on the other side that talks about the passing of a wand over or the

inaction by Washington as being some sort of blessing, I would like an opportunity to say, oh, no, based on the evidence, just the contrary. Let the jury reach its own conclusion. Let them argue that the SEC was not --

THE COURT: The problem is, if you get into that, you are going to try this entire industry in this case and we'll be here for the next month.

MR. BEEBE: I'm just about done, your Honor. I think that's exactly why the objection I made the first day they brought this up, last Thursday or Wednesday with Mr. Bishop, the SEC is not on trial. That's what I tried to foreclose, the raising of this whole issue. I would like a direction that they not re-raise it at this point and that they not argue it as part of their case in the closing because it's just not fair to give it to him and not me.

THE COURT: I take it your answer to my question, yes, you would be satisfied with that?

MR. BEEBE: If you don't charge it and he still argues it --

THE COURT: If I'm not going to charge it, it can't be argued.

MR. BEEBE: Then I would be satisfied.

THE COURT: Mr. Brooks, I can see the fact they would want these to meet your argument and you then have to be given under the law the right to rebut these. We then would get into a case that has no limit, which is what I find troublesome. Let me see if there isn't some way to cut this Gordian knot.

MR. BROOKS: Your Honor, perhaps those passages which you find to have some relation to McDonnell & Company be read into the record.

THE COURT: It hink it inappropriate to put in a sentence such as"we believe immediate steps must be taken by the board of governors to rectify the improper practices which have crept into the application." That is a clear statementof opinion without an opportunity to cross-examine the opinion maker on what he's talking about.

I deem it inappropriate to have that taken against the exchange.

On the other hand, if that isn't in there, Mr. Beebe, the letter is worthless to him.

MR. BEEBE: In paragraph 12 on page 3, I don't know whetehr -- I find that even more supportive. It's characterized in the top of the letter as a finding.

"The administration of the rule has been

characterized by relaxation of previous applications and interpretations or judgments made to bring firms into purported compliance."

Opinion, I don't know, sir if it's by the guy who is in charge of the whole show --

THE COURT: He's not here to be cross-examined on his opinion.

MR. BEEBE: That's why I don't want to try that case.

THE COURT: That's why I don't want to let these exhibits in evidence.

MR. BEEBE: We have this chart.

THE COURT: I appreciate that.

(In the courtroom in the presence of the jury.)

MR. BEEBE: I now call James McDonnell.

J A M E S M c D O N N E L L, called as a witness in rebuttal, having previously been duly sworn, testified further as follows:

DIRECT EXAMINATION

BY MR. BEEBE:

Q Mr. McDonnell, you have been here through most of the trial and you testified earlier.

I am going to ask you about Mr. Olney's testimony. Do you recall hearing that?

A Yes, sir.

Q Mr. Olney testified that a few of the McDonnell brothers and sisters were approached in January, 1969, concerning making a contribution or loans to the company.

Were you one of the people who was approached in January or early February, 1969, to make any loan or any kind of investment in McDonnell & Company?

A No, sir. No way.

Q Did you know or had you been told by anyone before you committed yourself to purchase McDonnell stock anything about net capital violations of McDonnell & Company?

A No, sir. Nothing.

Q Were you told or did you know independently about two partners withdraw from the company with $400,000 in January --

THE COURT: This is part of the main case.

MR. BROOKS: I object. This is not proper rebuttal.

THE COURT: This is not rebuttal.

MR. BEEBE: I believe this goes to the issues that was raised --

THE COURT: This is one of the items that you were arguing on the law questions at the end of the plaintiffs' case. So I don't see that this is rebuttal.

MR. BROOKS: I move to strike all the testimony except the first question and answer about Mr. Olney's testimony.

MR. BEEBE: I believe, your Honor, that this short line of questioning is relevant as to the state of mind that has been thrown into issue.

THE COURT: I thought we went extensively into that with Mr. McDonnell, getting into this subject of two luncheons in Detroit and the packages of pages that were submitted to him, and his state of knowledge before then and thereafter on his direct examination.

MR. BEEBE: Let me try just one more question, which would be the end of that line, and it is as follows:

Q Pause a second before you answer.

If you had been told of net capital violations of McDonnell & Company prior to your making your commitments to buy the stock, would you have bought the stock?

MR. BROOKS: I object your Honor, and I renew my motion to strike all of this testimony except the first question and answer as not being proper rebuttal.

MR. BEEBE: I believe this is a perfectly proper question.

THE COURT: Sustained.

MR. BEEBE: I believe that on the case after the law arguments, sir, through Mr. Olney the question of what the family knew and didn't know was explored extensively, and this question goes to that issue.

MR. BROOKS: Not with respect to James McDonnell.

THE COURT: This gentlemen was on the stand and was questioned all about his knowledge and his conduct and the reasons for it.

Sustained.

MR. BEEBE: Well, I have no further questions except I would have asked the same line of questions concerning advising his mother, but I assume I would meet the same

objection, and there would be the same ruling?

THE COURT: Yes.

MR. BROOKS: The same objection. Mr. Olney didn't speak to Mr. McDonnell at all. He didn't testify to that.

THE COURT: Sustained.

MR. BEEBE: Very well, and I thank you, Mr. McDonnell. I told you it would be short.

(Witness excused.)

MR. BEEBE: I called Mrs. Murphy.

MR. BROOKS: Was my motion to strike granted?

THE COURT: What is it that you want to do? I didn't hear anything that came in that requires striking.

MR. BROOKS: Well, I think you agreed that it wasn't proper rebuttal once he got beyond what Mr. Olney said.

THE COURT: He was asked if he was asked, and he said in no way.

MR. BROOKS: I agree that was proper rebuttal. I think all the questions and answers thereafter were improper.

THE COURT: I don't think there were any.

MR. BROOKS: I think there were.

THE COURT: Well, let me ask the reporter to just briefly read that.

(Record read.)

THE COURT: We only had one question.

Now, Mr. Brooks, it seems to me we had a lot of cross-examination about what a footnote on Exhibit J meant, which is the very same --

MR. BROOKS: Cross-examination of this very witness.

THE COURT: Of this very witness. So this adds nothing to what came out on cross-examination with regard to Exhibit J compelling me to strike it.

MR. BEEBE: I don't think it had gone far enough.

THE COURT: Nevertheless, on your motion I will strike it.

MR. BROOKS: Thank you, sir.

MR. BEEBE: Mrs. Murphy please.

M A R G A R E T M.A R Y M c D O N N E L L M U R P H Y, called as a witness in rebuttal, having previously been sworn, testified as follows:

DIRECT EXAMINATION

BY MR.BEEBE:

Q Mrs. Murphy, when you made your subordinated loan of your stocks in late January or early February, 1969, were you asked to buy any voting stock in the company?

MR. BROOKS: Same objection your Honor. Nothing

to do with our case.

MR. BEEBE: This comes in on the issue of Mr. Bishop having testified about people who were participating in the company got voting stock and people who were non-participants outside of the inner workings of the company didn't get voting stock.

THE COURT: Overruled.

Go ahead.

A No, I wasn't.

Q You testified at transcript page 37 in your initial case concerning what Mr. Olney told you; and then Mr. Olney testified that he had not told you about underwritings; that he had not guaranteed you that there were no risks; that he had not talked to you about selling the seats on the floor of the stock exchange, the paintings in the office and the furniture, and he had not promised you that there was no way you could lose your money.

After hearing Mr. Olney do you want to change any of your earlier testimony?

A I don't want to change anything.

MR. BEEBE: Then, your Honor, I would pursue the same line of questioning that I just had rulings on with regard to Mr. McDonnell, and I assume if I did I would be faced with the same objections and same rulings?

THE COURT: Yes. I would sustain them.

MR. BEEBE: I have no further questions of this witness.

THE COURT: Any cross-examination?

MR. BROOKS: No questions.

(Witness excused.)

MR. BEEBE: I think we said that Exhibit 107 for identification may come in as an aid to the Court?

THE COURT: Have you had a chance to look at this in any way?

MR. BROOKS: No, I haven't had a chance to look at it, your Honor, but I heard some testimony from Mr. Bishop which essentially casts doubt on its completeness. Essentially it shows all the bad marks and none of the good marks. So I object.

MR. BEEBE: Well, I would say --

THE COURT: Why don't we take argument on this outside the presence of the jury.

Other than this, is there anything?

MR. BEEBE: Other than this there is 96A which is the retyped version of 96 which I will find in short order and put in. I believe it has been corrected by Miss Solomon, and we will then rest our case.

THE COURT: Ladies and gentlemen, we will stand

slh8

in recess I think until 10:30 tomorrow. We are one day behind schedule. So tomorrow you will arguments of counsel and Wednesday you will get the charge of the court and commence deliberations.

I will see you at 10:30.

(The jury left the courtroom.)

THE COURT: I take it all sides move for directed verdicts in favor of each?

MR. BEEBE: So moved.

MR. BROOKS: Yes.

MR. STEIN: Yes.

THE COURT: I will reserve decision on all of them.

MR. BEEBE: Sir, may I ask when we will have the charges or summations?

THE COURT: That is one of the reasons I wanted to get an extra half hour tomorrow, because they are not in final form.

MR. BEEBE: Should we convene a little earlier so we can discuss it?

THE COURT: Yes, be here at 10.

MR. BROOKS: Do I understand the plaintiffs have now rested with two exceptions, discussion on Plaintiffs' Exhibit 107 for identification and admission of 96 as to which there is no objection?

THE COURT: Yes.

The problem with 107, Mr. Beebe, is that I too am looking at this; I keep looking at this column and saying where are all these bi-weekly McDonnell reports?

MR. BEEBE: I don't think there are a lot of them in evidence. I really did go through -- well, obviously the left-hand column, the McDonnell column, is going to show things all being low and good and so on --

THE COURT: We have some exhibit that Mr. -- I don't remember his name -- that he put in evidence earlier in the case which had five or six of these.

MR. BROOKS: McElroy?

THE COURT: McElroy, wasn't it?

MR. BEEBE: Yes. Those are all in the center column. That is out Exhibit 25 I think.

THE COURT: No. He had several handwritten pages of schedules.

MR. BEEBE: Well, let's see if I can pull that out.

MR. BROOKS: Triple X, your Honor. There is a computation by Mr. McKay which showed a 1900 ratio as of January 30th.

MR. BEEBE: That just came in. That came in after --

THE COURT: There is another exhibit that had five

s1h10

or six pages in handwriting.

MR. BEEBE: I think I know which one you are referring to.

THE COURT: Here it is, Exhibit 35.

That exhibit has a ratio starting in February and running through March.

MR. BROOKS: There are also computations by the exchange which shows that after the 500,000 deposit on January 30th the firm was in compliance, and there are similar ones that show that after the February 20th million dollars plus deposit the firm was in compliance.

THE COURT: There was a September ratio here with a 1569 --

MR. BEEBE: September of what year?

THE COURT: 1969.

MR. BEEBE: This is the 1968, sir. You will see, mine really starts going --

THE COURT: I know, that's one of the problems. I am troubled by what it has in it and what it doesn't have in it.

MR. BROOKS: The 1968 ratio is attached to Plaintiffs' Exhibit 35A, your Honor. Mr. Schuette's schedule show a whole bunch of ratios also in compliance with the capital rule.

slhll

THE COURT: Which one is this?

MR. BROOKS: Exhibit 35A.

MR. BEEBE: That is what his Honot is addressing himself to.

THE COURT: That's the very one.

MR. BROOKS: I think there are others throughout the period where we do have an equal amount of good ratios.

THE COURT: We have the one for December 31st, I think.

MR. BROOKS: Yes.

THE COURT: And it is not until January 12th that we have the first one that exceeds --

MR. BEEBE: January 13th.

But, your Honor, it is right on there, and I would say that the purpose of this primarily is to show that there is none, just what I was asking Mr. Bishop on the stand. I believe that there really is not one that the exchange found after October 31, 1968.

MR. BROOKS: Mr. Bishop testified that all those times when they didn't charge a violation there was compliance.

MR. BEEBE: I found that pretty ridiculous.

THE COURT: I do not think I would permit that as an exhibit for the jury incomplete as it is, and I think

to the extent that it is a discretionary matter with me at this point I am not going to permit it.

You can, of course, argue from those figures all you want.

MR. BEEBE: Can I make just one suggestion?

THE COURT: Yes.

MR. BEEBE: That I would undertake tonight to put in the earlier figures from Exhibit 35 and any place else I can find; there is another Lybrand figure that is not here that is also above 3,000, and give it to Mr. Brooks early tomorrow morning, and if he has some others I will add his. I would rather have a complete exhibit.

THE COURT: Well, you gentlemen have other things to do tonight than to prepare schedules.

MR. BEEBE: Well, I am all set to go.

THE COURT: All right.

(Adjourned to May 20, 1975, at 10 A.M.)

MARGARET MARY McDONNELL MURPHY, et al.
v.
McDONNELL & CO., INC., et al.

May 20, 1975,
10 A.M.

--

(In the robing room.)

THE COURT: Now gentlemen, with regard to 104 and 105 for identification and the issue of arguing to the jury, did the Securities and Exchange Commission give its imprimatur to these transactions, Mr. Brooks, I am going to take that issue out of this case based on Mr. Beebe's concession to me yesterday that would be satisfactory to him; that if it were out he would then not press 104 and 105 for identification.

Now let me just give my thoughts on this so you may know the way I am thinking, and you may try to argue me out of this, but I have agonized over this to some extent, and I think that would be best.

These letters, coming in as they do at the tail end of the cross-examination of Mr. Bishop, at the twilight of this case, create a lot of problems.

I concede that certainly 104 in its paragraph 12, while it doesn't mention McDonnell, arguably refers to things that have gone on in this case; arguably, not clearly but arguably.

And yet if this letter were in, I would regard it as a prejudicial document all by itself.

I note that it is not being offered as a statement of opinion by anybody at the SEC because it is not being sponsored by that person subject to cross-examination. It is only being put into this record as something that came to the attention of Mr. Bishop, and it would not come in, Mr. Beebe, for the truth of the matter contained in it, other than it is a statement of the SEC to a certain extent that comes to Mr. Bishop's attention, because neither Mr. Pollack nor Mr. Cohen are here subject to cross-examination on any statement of fact. Therefore that is inappropriate, to treat it as a statement of fact.

On the other hand, if the letters were in, Mr. Brooks would then be definitely entitled, in my judgment, to an adjournment of this trial to deal with these letters, whether he wants to call a participant or call Mr. Pollack or call Mr. Cohen, or whatever.

And it is for these reasons that I feel that given the fact that these letters are after the fact, that they would broaden this case all out of proportion, because we would then have occasion following the review of the Commission's oversight of the entire industry, which could conceivably be as long a trial as the one we have already

been on just involving the McDonnell Company - I would feel as a matter of discretion I would accept your proposal and, based on that, exclude these exhibits.

Now, Mr. Brooks, what say you to this?

MR. BROOKS: Your Honor, I think we can solve the problem without completely cutting away the role of the SEC, because I think it is important.

Under 19(a) of the Exchange Act, the SEC had the clear authority over McDonnell, and we have seen quite a bit of evidence that it scrutinized McDonnell, had its examiners in there, and got essentially the same reports as the exchange.

I appreciate the problem in the two exhibits, because as our charge was cast, it said the SEC knew what the exchange was doing in respect to McDonnell and didn't do anything about it, and therefore could be said to have approved the exchange's program for McDonnell.

However, I think that we can say that the SEC knew whatever information the evidence shows it knew about McDonnell and did nothing to McDonnell. No mention of the stock exchange or its program, and I have proposed two modifications of the charge 33A.

THE COURT: Have you seen those, Mr. Beebe?

MR. BROOKS: I have given those to Mr. Beebe.

MR. BEEBE: I have seen those just this morning.

I am quite troubled by those because the same issue is there, the issue of tacit approval, or whatever the SEC did or didn't do, or did or didn't know, without my having an opportunity to present the SEC's side of the story.

The SEC is not on trial here.

It is not -- well, I will let you read those and then I will make my argument.

THE COURT: Suppose we took 33, the shorter, and changed it to read, in substance:

In determining whether the exchange purportedly regulated McDonnell, you may consider the conduct of the SEC given the information it had available to it at the time.

MR. BEEBE: I think completely not, sir, because what it forces me to do is say that the SEC, one, didn't have the right information; two, had some sort of motivation not to act - this is what Congress later said was what happened - and three, the fact that the SEC does not act, as you know, sir, from no action letters, and things like that, is never a sign of any blessing by the SEC.

The SEC says: Unless we affirmatively tell you that you can do it we always hold the right to come against you for what you have done.

And, sir, in this case -- this is something I didn't bring up yesterday because I thought the issue was put to bed - the SEC did act. Exhibit K and L, which is within Exhibit 16 of this trial, the SEC actions --

MR. BROOKS: I think they were taken off the exhibit when they were in, your Honor.

MR. BEEBE: I am not sure that is right, but I may show them to his Honor?

MR. BROOKS: Sure.

We don't dispute that the SEC took action after McDonnell --

MR. BEEBE: Of course they took action.

I think they are in evidence, but that is not --

THE COURT: No, they are not, as I remember it.

MR. BEEBE: Were those the ones that were taken out?

THE COURT: Yes, those were the ones that were taken out.

MR. BEEBE: Then they should be in evidence if we are going to join the SEC issue.

That is really my basic point, is that all along in all the exhibits, many of which I offered yesterday, your Honor, yesterday morning, in the case study, and so on, all of them go to what you said is not an issue in the case because it is trying the SEC case, and they are just kind

of bringing it back in here.

Can I make one other point?

THE COURT: Yes.

MR. BEEBE: And the other point is that under Section 6 the Stock Exchange takes upon itself primary responsibility for enforcing the laws, and that's what the Stock Exchange said they were doing here.

Now to turn around and say the SEC didn't do something and therefore we have got a blessing and turn the statute on its head --

MR. BROOKS: I am not asking for a blessing of the Stock Exchange, your Honor; I am asking for a charge that the SEC had concurrent authority over McDonnell and knew certain things about McDonnell and did nothing until after March 13th.

Paul McDonald testified he went down to the SEC and told them he needed six weeks and got the six weeks. I think that is something the jury can consider.

THE COURT: Well, I think, Mr. Brooks, in the overall this opens up that the law describes as a can of worms that I am not going to permit to be opened here.

So I will withdraw that issue based on Mr. Beebe's representation that that would be appropriate to him.

MR. BEEBE: I think if it is out of the case that's

the best way to handle it at this point.

Now, some things are in evidence, because Exhibit OO or OOO the letter that they sent down, the SEC, I don't know how I am going to deal with those.

THE COURT: Now I am going to take certain issues away from the jury, and this has to do with what you can expect in the way of charges, and will cause you to want to exercise a blue pencil in the course of your summations. So certain magnificent words and phrases that you were prepared to hurl at the jury you can delete.

I am going to take out of the case the fraud claims based on 10(b)(5) insofar as they are asserted against the stock exchange.

I don't find any proof here -- and, Mr. Beebe, hear me out on this, and if you can persuade me to the contrary I will be prepared to listen to you -- I don't find any proof here that the exchange had any knowledge that Murray McDonnell's statements were being made, let alone were fraudulent.

I don't find any proof here that the exchange had any reason to suspect that Murray McDonnell, assuming he was committing fraud, in fact had fraudulently obtained any money.

I don't find, certainly in the context of this

case, that it was the duty of the stock exchange to screen the knowledge of the contributors to the capital of the company, given the circumstances we have before us on this trial; nor do I find that there is any duty as a matter of law, certainly in the context of this case, on the stock exchange to inspect the signatures on the roll over of this debenture to see that Murray McDonnell did not commit the fraud that he is alleged to have committed.

The proof as I remember it that went to the inspection of the trust instruments went to see whether the trust had the power to put the money into this kind of an instrument, not whether specific procedural steps had been in fact taken.

As a result of this I don't see that the plaintiff could justify a 10(b) recovery against the exchange either with the exchange as a participant in this fraud in some way, or as an aider and abettor, or as a control person.

pqrl

I must say I do not understand how it was arrived at, the determination of the controlled person. It seems to me a regulatory body is chargeable to the extent it has to be regulated and not under some other additional or lesser duty. It seems to me that any other conclusion here would make the stock exchange an insurer because what you get into, as I see it, is if the exchange has a duty to supervise, let's say, what is told Mrs. Murphy, suppose they miss something and some very able lawyer like Walter Beebe is going to come in and say they didn't tell them item 6 and item 9, and alternatively if the stock exchange, bending over backwards to make sure they told them every item, tells them 25 items. The company is going to say "We would have gotten this money and stayed alive if you had not told so many things" and the borrower says "If the stock exchange took 25 minutes to tell me these things, I am not interested.

Also, a lender could claim that the stock exchange puts its primatur on the loan thus becoming involved. You would have an entirely different matter, in my judgment, if the exchange knew the money had been obtained by fraud. We don't have any such thing.

I don't regard, I don't think you really regard, any more the knowledgeability letter as bearing

pgr2

on this.

MR. BEEBE: I'll answer when I can interject.

THE COURT: It is not a letter imparting any knowledge. I don't see that it made any difference. They would have signed it anyway and the money would still have gone in.

Mr. Beebe, do you have anything you want to observe that might cause me to feel differently on these items?

MR. BEEBE: May I ask first, sir, are the rest of the charges substantially going in?

THE COURT: Let me get to that.

As far as the regulatory claim is concerned, I am withdrawing from the jury those aspects of it which impose a duty on the stock exchange to supervise the representations that McDonnell makes to anybody. I don't think Section 6 puts upon them a duty to supervise Murray McDonnell's statements to his sister.

MR. BEEBE: Or to any outside --

THE COURT: Or to any outside lender without being aware that there is some fraud involved.

There is no history here that McDonnell & Company had ever failed to disclose information in the past, so the exchange was on notice that Murray would be

running around the country committing frauds if he did. I don't see that you can infer this from the speed in which the money was gotten into the company, particularly where it's normal in this industry that speed is needed when there is a net capital violation.

To contend to the contrary, as a matter of law, it seems to me the stock exchange would have to be present at family discussions and make sure that McDonnell said what the exchange felt it was obligated to say anyway under the securities law.

I incorporated in there my thoughts earlier about putting the exchange in the position of being an insurer.

Also, Mr. Beebe, do you contend that McDonnell should have been immediately suspended on January whatever it was in 1969 upon the Lybrand report coming in?

MR. BEEBE: I think I have spread my contentions on the record that they should have. As soon as the problems arose and grew grave, late in 1968, the stock exchange should have begun to take measures to do something about it and they didn't.

THE COURT: Should they have suspended?

MR. BEEBE: What they didn't do is important.

pgr4

They didn't do anything. And I think the important thing about 1968 and into 1969 is that they had a whole array of alternatives available to them and they didn't persist in any of them.

THE COURT: Specifically, do you intend to claim -- and then I would ask you what the proof is you base it on -- to this jury that there should have been a suspension of McDonnell before the plaintiffs put their money in in late January and early February.

MR. BEEBE: I have earlier answered that as best as I can.

THE COURT: I wanted to be sure. You claimed you didn't claim that. I want to be sure.

MR. BEEBE: I think I have spread my position in the record in the course of the argument at the end of the plaintiffs' case. Since then we have strengthened it a great deal in showing through the Stock deposition and Mr. Bishop's on the testimony that there were an array of alternatives tothem, none of which they drew upon or used.

I also would have, if given an opportunity to show the Piccard situation, that they did take strong measures. I submit they took proper measures that they didn't take here.

pgr5

They also took measures later in '69. Why not earlier? Why didn't they take them earlier? Because they bought the time with our client's money.

Is there anything else to go to the jury on other than this?

THE COURT: I want to await your argument.

One of the things I am not clear on in my own mind is to what extent you will marshal the facts in terms of the reasonableness or unreasonableness of the regulation. We had an entire day's argument on this at the close of your case. There is not a lot more in the case. I'm going to await hearing what was given to the jury on that.

It seems to me that the jury should be told by you that they can find for the plaintiffs on the ground that McDonnell should have been suspended upon receipt of the Lybrand report. I wanted to see what evidence you had.

MR. BEEBE: I put it in terms of strong regulatory measures being taken. I don't pinpoint one particular arrow pulled out of the sling as opposed to what was available to the stock exchange. There was mention of fines, censures, disciplinary proceedings. They could have sent letters, warning letters. They

could have sent a letter as far as capital was concerned without having any need for a formal violation being found as early as September 4 when that first little note by Mr. Waterbury which said: Why don't they get more capital? He was a pretty high official. He was assistant chief examiner. This was not some local little fellow down in the ranks.

He said that: Why didn't they get more capital? Why didn't they take some steps to do something?

Are there any other blue pencil items you are thinking of?

THE COURT: No.

MR. BEEBE: May I ask you, with all due respect, what is left in the charges?

MR. BROOKS: Let me raise a question first.

MR. BEEBE: I have to come back to these two particular items that I do want to address. I would like to know if there is something left of the charges that still gives me a case to go to the jury on.

MR. BROOKS: I would like to ask whether Section 6, James McDonnell, still remains in the case in view of Judge Lasker's decision.

THE COURT: As to the balance of the

regulatory case I want to hear what the summations are.

MR. BROOKS: There is nothing in the summation which would really be directed to his status as a voting stockholder. The person who acted as a partner, as in the Sloan case, that's a decision of law as to whether such a person has standing. Sloan, Judge Lasker said, the general partner, did not. When you have a corporation that's a member firm, I think the voting stockholder who was active in the management, as James was, is in the same boat.

THE COURT: I want to hear argument on all of this. When I have heard the factual picture --

MR. BEEBE: I would like to say some things about 10B5 regulatory points. It's something that needs some attention if there is still room for persuasion.

THE COURT: I would be glad to listen, but I have been grappling with this problem since the first week of the case.

MR. BEEBE: I start with 10B5, your Honor.

First, I refer to our brief and to the law in this area and all the prior arguments and the evidence in the case.

On top of that, here you have an entity, the

New York Stock Exchange, that wears two hats, both the regulatory hat and the self interest hat, which I think you have seen a good deal of evidence about.

Here is an entity that obtains a great deal of knowledge about -- just take it as given at the moment for the purpose of this juncture right now -- obtains a great deal of knowledge which is adverse, materially adverse, and then we'll take two courses. One course sits on the sideline and doesn't do anything. What happens here, however, is under its own, for its own reasons, it goes and orders McDonnell to go out and raise the funds. That puts it in quite a different position than a non-participant.

It did have knowledge; not just reason to suspect, but it had positive knowledge of the adverse facts and it took no steps to make sure that that knowledge was transmitted to whoever was going to be the contributors of the money.

Remember, your Honor, in the exhibit dated January 9 they mentioned that an institution was going to contribute the money. Later on there were other people that seemed to be coming in with money. There was never a mention of family.

In fact, Mr. Bishop took the whole family

out of this case when he conceded on cross-examination that he didn't even know that they were going to the family. He didn't know about the family until the family came in.

At that point, I respectfully submit, when a fellow knows that a guy is going to go out and tells him to go out to raise the money and doesn't do anything to make sure that the adverse information is communicated, he is aiding and abetting a 10B5 fraud.

You keep mentioning Murray McDonnell talking to his sister and mother. They didn't know that was going to happen.

When I talked about knowledgeability letters, the importance is that some step is taken -- you don't have to call it an acknowledgement letter -- some notice is given to the potential investor of the materially adverse facts. I submit knowledgeability letters is not enough notice. They didn't do that bare minimum. That's the important thing.

I'd say very straight down the line, I think it's a mistake to take this away because this is really an important step that a guy in their position has to take. The New York Stock Exchange has to do something to communicate this information.

THE COURT: I don't agree to this extent, which I think changes the picture a little bit:

The exchange didn't direct them to get the money. The exchange in substance told them if they didn't have the money in two days the firm would be closed. It is not "You go get the money," and therefore there is a duty to see to it. They are saying "If the money is not here we have no alternative but to close this firm down."

MR. BEEBE: May I respectfully suggest if you are going to do this -- I'm narrowing it for the moment to the 10B5 point -- you do it after the jury comes back. You said the implication is there. The jury could reach a different implication. I think in fact the contrary. Mr. Bishop came in, stood behind the chair, and directed, commanded, "Go raise the funds."

THE COURT: There comes a point in June that the same command is in existence and they don't get the funds.

MR. BEEBE: I'm not claiming fraud in June. I'm claiming it right then and our people --

THE COURT: It's a question as to whether the exchange has to get into the relationship between

the borrower and lender at this point.

MR. BEEBE: It's aiding and abetting. Let the jury decide that.

THE COURT: They don't know what Murray says. If they knew, that would be another matter.

MR. BEEBE: They didn't take any steps to make sure the information is communicated. It's not as if they had no relationship with the parties. They did have one. They had the relationship of Section 6, and that relationship is protective of subordinated lenders, and that's the special situation here. That's the nexus, the connection, between the two, and I think the jury should have been able to decide that otherwise the gist -- that's what their duty is. They're not womeone out in left field. They're right in the middle.

THE COURT: Do you want to argue that, Mr. Brooks? I grappled with this problem for a couple of weeks now.

MR. BROOKS: Your Honor, I think in all the cases, they are to the contrary to Mr. Beebe's argument. Taking the Beebe case in Chicago, he had essentially the same kind of situation where a person bought some voting stock in the firm. His name came in for approval as a voting stockholder. They said he could be a

voting stockholder. The judge found the exchange was not a party to that transaction. He found that the company from which he bought the stock had no responsibility.

When you don't know the fraud and you don't actively participate in the transaction you don't have the responsibility. When you have a brother talking to a sister, and a brother talking to a mother, and a brother talking to a brother, admittedly the exchange did not know about it, but after these applications came in, is the exchange expected to go and intrude in that relationship and say to Mrs. McDonnell, "Your son, who has been running this firm since 1945 and knows all about the security laws because he's underwriting every day, and he has an advisor, did he tell you the real square story, Mrs. Anne McDonnell?" She would have thrown him out. It's ridiculous.

THE COURT: Given my rulings of this morning, do you want 20 minutes to recast your opposing arguments?

MR. BEEBE: I had paused after the 10B5. May I address the regulatory one for a moment?

THE COURT: Yes.

MR. BEEBE: I don't understand it --

MR. BROOKS: As to who carries the burden --

THE COURT: I'm not clear, Mr. Brooks, as to whether it is or not. I'm not clear because I never have been able to understand in this case what the claim is with regard to anybody's ability to get out.

MR. BEEBE: That's their burden.

MR. BROOKS: I thought it was the plaintiff's burden.

MR. BEEBE: If they say I could have gotten out or done something else, that's for them to prove.

Can I address --

THE COURT: I have reserved decision. The factual problems of going in and coming out, maybe yes and maybe no, have been very troublesome. That's why I want to hear the summations on these issues.

MR. BEEBE: May I go back and address the regulatory, and one more thing on the 10B5 which is mixed into the regulatory here. You covered them both.

You say that you are troubled with a regulatory agency telling people adverse facts and therefore it becomes some kind of insurer and might not it be liable to someone if it goes too far. When you have the

relationship of the duty of one to another you have what is called a qualified privilege. That's what they had here.

They could have and should have told people. They can't hide and conceal these things based on some claim that it's bad for them and it's bad for the New York Stock Exchange if they reveal it. That's a fancy way of committing a fraud.

There was a fraud committed here. I think based on all the evidence in this case it is clear there was a fraud committed.

The regulatory duty, you are saying, the duty to supervise representations to outsiders, is not part of the Section 6 duty and there is no duty of due care by the regulator to find out whether they were or were not committed, and the regulator doesn't have to do anything about that. I take an exception to all these because I don't think that's the way it works.

THE COURT: Mr. Beebe, just a comment on that, your last observation.

These are family transactions which strengthen my position.

MR. BEEBE: They didn't know it was family.

THE COURT: One of the puzzling aspects of

this case is that nobody sued Murray. Nobody called Murray McDonnell. Nobody read from the deposition of Murray McDonnell.

MR. BEEBE: That's why I wanted to read WWW. That was Murray McDonnell's letter.

THE COURT: That's an uncrossexamined apologia and plea but I assume somebody took a deposition.

MR. BROOKS: At length.

THE COURT: Mrs. Murphy didn't want to sue her brother and Anna didn't want to sue her son.

MR. BEEBE: Your Honor, the New York Stock Exchange didn't sue Murray. They subpoenaed Murray as I did and they didn't call him.

THE COURT: I find that interesting.

MR. BEEBE: I don't ascribe to that. That's not on the record.

THE COURT: I call attention to that, when you get down to saying the stock exchange participated in this fraud, this was a bunch of family telephone calls. That leaves you in the context of this case in less than a sympathetic position.

MR. BEEBE: All I can say --

THE COURT: Maybe Murray has no money to pay Mary but it is interesting that the man allegedly who

made all these false statements is not in the courtroom.

In any event, go ahead.

MR. BEEBE: I would like to go ahead.

We put in a proposed charge that said in essence there is no family exception to the securities laws.

THE COURT: I would be perfectly pleased to make the statement that who the parties are doesn't have any legal effect here.

MR. BEEBE: That also goes to the point you were just raising. The other point is that I could --

THE COURT: The point I was raising was an observation and not a point.

MR. BEEBE: The observation then.

I would say at the beginning of the case I expected them to argue along the lines you are saying. I would not buy that argument but I expected to hear that. There is a good reason for not hearing it from their side that they relied. They can't argue that they relied on Murray telling the brother and sister because they didn't know ahead of time, but that's where the money was coming from. That is vital. I can't underline that enough. They didn't take any steps.

The doctrine of wanton disregard, do you know

that? They had wanton disregard of their obligations.

THE COURT: Let's somehow bring this to a close.

MR. BEEBE: I said my piece. I am not sure what is left in the case.

THE COURT: I assume reasonableness or unreasonableness of regulation leading to events at McDonnell & Company and the proximate cause between that and clients' losses.

MR. BROOKS: While on that point, I think I will be discussing some knowledge thatthe parties had after they make their transaction because I think it goes to proximate cause, the argument that they knew of the problems and could have gotten out and made no effort to get out or even explore that opportunity. So if you hear some disclosure argument, it goes to that.

THE COURT: I understand. You are all competent, fine, counsel here. I am sure you will argue appropriately.

MR. BEEBE: I'm going to try, sir.

There is the unreasonableness of the New York Stock Exchange regulatory conduct under Section 6.

THE COURT: You have been arguing that their regulation was unreasonable and that that caused your

clients damage.

MR. BEEBE: That's one of our contentions. That's still there.

THE COURT: You find it to be there? I expect to hear you argue it.

MR. BEEBE: Yes.

The other point, the debenture rollover and how that works here.

When you have funds in here --

THE COURT: Mr. Beebe, I'm not going to rule on that. Mr. Brooks asked me about it: Is that in? I await hearing the factual presentation on it. I'm troubled, still troubled, by various aspects of whether the record supports this claim or that claim.

MR. BEEBE: I would like an opportunity before you make some final determination, if it's going to go against me, to be heard on that.

MR. BROOKS: Would you advise the jury you have carved out the fraud claim with respect to their consideration?

MR. BEEBE: I don't see how you do that very well.

THE COURT: I'm going to submit to them what the issues are.

MR. BROOKS: That issue against the exchange will be regulation and not disclosure.

THE COURT: That's right.

MR. BEEBE: I have to draw the fine line of talking about the 10B5 issue just against McDonnell & Company.

MR. STEIN: I'm a little puzzled about the debenture situation as to whether or not there is a 10B5 case here. What you may have here, if Mr. Beebe is correct in his allegation, is a malfeasance case on the part of a trustee, which claim could probably be brought by a beneficiary of the trust or one of the co-trustees.

THE COURT: I don't know that we need to argue that. I'm not going to rule on it as a matter of law. I will leave that to your assessments of the evidence in a three-weeks trial at this point and then we'll go from there.

Do you want 20 minutes?

MR. BROOKS: Yes.

MR. BEEBE: Half an hour, please.

(Recess)

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(In the robing room.)

MR. BEEBE: As we assembled out there Mr. Stein approached the lectern and gave indications he was going to go first.

Mr. Stein went first in the opening, and in this district it is always in the reverse order.

So if I went first Mr. Stein came second, and then Mr. Loflin and then Mr. Brooks. It is in the reverse order, and, in fact, Mr. Stein and I had colloquy yesterday to that effect, and I am surprised they are trying to reverse the order, and I naturally object.

MR. BROOKS: Would you like to go first?

MR. BEEBE: I would like you to go first in the regular order.

MR. BROOKS: I don't want to go first.

MR. BEEBE: It is the reverse order, your Honor, always in this district.

THE COURT: Mr. Beebe, the rule usually is that on a side the parties can within limits adjust their own, and if there is a dispute the judge generally makes them go in the way the caption runs.

Now, the caption here would cause McDonnell & Company to go first and then go up the line.

MR. BEEBE: As I understand it, it is the reverse

order than it was in the opening statements.

MR. BROOKS: I never heard that rule, Mr. Beebe.

THE COURT: I never heard that rule either.

Let me ask you, what difference does it make?

MR. BEEBE: It is only what the usual practice is, as I understand it, and I think it is the correct way to do it in this district, and if it is going to be changed around in this situation, I guess there is nothing I can do except note my objection on the record.

THE COURT: All right, note your objection.

(End of robing room discussion.)

(In the courtroom in the presence of the jury.)

MR. STEIN: Good morning, ladies and gentlemen:

We have now reached the point in the case where the lawyers have the opportunity to discuss the evidence in the case, and to draw certain inferences from the evidence.

I know you have been sitting here for a long time now, and I would like to thank you for your consideration and your attentiveness, and also acknowledge the fact that we lawyers realize that the task of a jury, particularly in a complicated civil such as this one, is not an easy one.

I do hope that it has been a rewarding experience, and that you go away from this case with a renewed appreciation for the legal process.

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I ask for your patience just a little longer because there is a lot of ground to cover, and I want to get right into it.

I think the first area of inquiry in a case in which there is a dispute between people, between human beings, whether they are corporations or whatever, is to consider who are the plaintiffs, who are the defendants, before you even get into what are they fighting over; because who people are and the way that people relate to each other, the relationship that they have with each other, I think tells us a great deal about the dispute. It casts a certain light on what we are dealing with.

I think that's true about an argument which is between people that takes place outside of a courthouse, and I think it is equally true about what takes place inside a courthouse.

So let's look at the character of the parties just for a moment here before we discuss any evidence.

Who are the plaintiffs?

You know that the plaintiffs comprise the widow of the founder of a now defunct brokerage firm that was called McDonnell & Company. Mrs. Anna McDonnell is a plaintiff.

We know that another plaintiff is the son of the

founder of McDonnell & Company, James Francis McDonnell, Jr., and we know that the third plaintiff in this case is a daughter, Mrs. Murphy.

Now, Mr. Beebe, who represents these plaintiffs in this case, when he made his opening -- it seems like a long time ago -- he mentioned that at least two of his clients, Mrs. McDonnell and Mrs. Murphy are not sophisticated investors. I think he referred to them as pigeons, was the expression he used, and that they were somehow taken advantage of by McDonnell & Company in the person of one, Murray McDonnell, who is not a party to this litigation.

Now, it is interesting to note, as it was interesting to me then, that no claim concerning lack of sophistication is made regarding James McDonnell.

Mr. McDonnell testified, and I don't think any attorney in good conscience could make the claim that James McDonnell is not a very sophisticated businessman.

Let's get back to Mrs. McDonnell for a moment, because Mrs. McDonnell unfortunately was not able to testify in the courtroom, but we did learn a good deal about the nature of her claim as a result of testimony that was taken outside of this courtroom some time ago in what Judge Owen has told you is called a deposition; and I think you get certain insights from Mrs. McDonnell's testimony, not only

her version about what took place here but what kind of a person Mrs. Anna McDonnell is.

For example, we know through her testimony and we know from the testimony of her attorney, Mr. Ford, who testified a week or so ago, that Mrs. McDonnell is said to be an astute person who always knew what she was doing in all facets of her life, and that includes financial matters.

So I think it is fair to conclude from what Mr. Ford said that Mrs. McDonnell, although you didn't see her, is a person who has a fair amount of astuteness, of sophistication.

Let's talk for a moment about Mrs. Murphy who has been sitting here for this entire time, whom you did have an opportunity to see on the witness stand, and you did have an opportunity to hear her version of the case.

Now, there is certain evidence in this case that I think indicates that perhaps Mrs. Murphy was not a neophyte or novice in the investment business when she came to lend her securities to her brother Murray, to McDonnell & Company in January or early February of 1969.

We know, for example, based on her testimony, as confirmed by Mr. Olney's testimony, that she had invested $150,000 in an aggressive hedge fund known as Mercury

Partners.

We also know that at some time previous she had made a rather substantial loan to her brother Sean.

We also know with regard to the transaction as to which it is claimed there had been some kind of fraud or wrongdoing, that Mr. Olney said that Mrs. Murphy was familiar with the problems of McDonnell.

So you have to bear in mind as you analyze and consider the evidence in this case, the kind of people that we are dealing with.

Now, those are the plaintiffs.

Now, who are the defendants in this case?

One defendant we know is the stock exchange. And I don't have to go into any great detail about the stock exchange.

Another defendant is the receiver of McDonnell.

Now, we learned a certain amount when Mr. Stargatt testified last Tuesday about a receivership, what it means, how a receivership works.

You may have asked yourselves the question: How did this all get to Delaware?

McDonnell & Company was a New York brokerage house. The plaintiffs in this case, except for James McDonnell, appear to be New Yorkers, or, at least, residents of this

area; and what is going on in Delaware is really a very simple explanation. McDonnell & Company when it was alive, was alive as a Delaware corporation. It is a formality that involves lawyers and accountants, that when a company is formed sometimes there are good reasons to go to a state other than the state where the company is going to do business in.

Delaware is a very popular place for corporations to be chartered or to be born out of.

Now, if we use that analogy -- and I don't want to carry it too far -- McDonnell & Company was born in Delaware some time in the early part of the twentieth century, and if it is going to die, if it is going to be put to death legally, it is put to death in Delaware.

So that the Delaware court oversees the demise or the putting to rest of a Delaware corporation. And in so doing the Delaware court tries to protect persons who might otherwise be injured by the demise of the corporation.

In this case what the Delaware court did was to appoint a man by the name of Bruce Stargatt to be its receiver, and it was Mr. Stargatt's job, as he explained to all of us last week, to go out and collect the money and assets, whatever he could so that these properties, let's call them, would be available to creditors and to put

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them in one big pot, and then to decide who among the many people who may have claims against McDonnell & Company as a result of their dealings with McDonnell & Company during its lifetime, are entitled to payment, and in what amounts.

So it's really a two step process. First the receiver goes out and he obtains whatever is owed to the company and he conserves whatever is in the company treasury, in the bank account, and any place else the company might have what are known in law and in accounting circles as assets, and then he sets up procedures so that the creditors can present claims which in this particular instance were in writing, and to inform the receiver what they believe is rightfully theirs.

Now we have a whole variety of people, claimants or creditors, who present claims, because you may recall three weeks ago when I stood before you and made some brief comments during the process of opening, it is necessary for a creditor to file a claim, and it is necessary for a receiver to look at the books and the records of the company and to make decisions.

In this instance, as in most instances involving receiverships or bankruptcies, the man who has the legal responsibility -- it's not like the president of a company, because the president of a company is usually equipped with

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some kind of knowledge as to what happened; the president of the company, even a large company, is likely to know, to have some familiarity with the underlying matters that gave rise to the claim.

So you have a receiver who comes in later on and doesn't have a heck of a lot to go on except the books and records of the company.

Now, really, his guiding light is fairness. He wants to be fair to all the creditors. He doesn't have an axe to grind. It is not a question of any personal profit; there are no personal motives. His responsibility is to the creditors.

Now, in dealing with the creditors Mr. Stargatt told us very, very generally what he did.

First he decided who are preferential creditors. A typical example of a preferential creditor is the United States Government. In your ordinary, garden variety insolvency proceeding, which is a receivership or bankruptcy proceeding, you always have the United States Government to deal with. They go in first.

The next group comprise a very significant group of people. Those are what is known as general creditors of the estate.

When you talk about a receivership or a bankruptcy

you talk about an estate in the very same way you talk about a person who dies and what he leaves behind. It is a collection of assets, properties, so that the general creditors in any situation are always significant in terms of number and in terms of right.

Now, in this particular situation Mr. Starrett talked about a third group of creditors, and these are what he called subordinated creditors. These are people as to which the books and records of the company showed that they made a different kind of a deal with McDonnell & Company. They said, "Pay me last. I am going to put my money in, or I am going to allow you to use my securities in order to shore up capital so that you can meet whatever requirements have to be met. I agree to be paid last."

Now, that agreement is in the files of the receiver. That agreement is reflected on the ledger sheets of the receiver so that the receiver can segregate these claims and then he can analyze them.

So that you have these three very distinct groups here.

In many receivership or bankruptcy proceedings, I will say in most of these proceedings, a subordinated creditor as a category is not terribly important. However, when you are dealing with a stock exchange member firm, and

where this concept of subordination was during the period of time involved here quite important, you do have this third category.

Now, the plaintiffs in this case are, as far as the books and records of the receiver are concerned, which Mr. Stargatt talked about, are in this group of subordinated creditors.

Now, what does that mean as a practical matter?

You have this pie -- let's think of it in terms of a pie -- and, obviously, the more creditors that you have sharing in this pie the thinner are the slices. That is what the lawyers and accountants call prorata distributions, and you can readily analyze in your own minds as just a pie.

Now, that's why it's so important to be fair to all the creditors, because if you don't screen and really put under a microscope the validity, the sufficiency of these claims, you might end up with creditors getting too thin a slice. You might end up with some creditors getting thin slices when they shouldn't be getting any at all and other creditors who should be paid not getting anything; and this is what Mr. Stargatt set out to do as any receiver would who reports to the court upon appointment.

Mr. Stargatt in analyzing these claims -- and I

want to emphasize this -- doesn't know the McDonnells, the McDonnells who are plaintiffs here. He, in fact, really is a representative of all the creditors, not only the subordinated creditors, not only the general creditors.

Now, why this lawsuit? Why did the plaintiffs in this case make the decision to sue the receiver of McDonnell & Company?

There was testimony by the plaintiffs and by Mr. Stargatt that the claim, the piece of paper that announces to the Delaware court and to the receiver, was allowed, and the fact is that the claim - the evidence of that fact is that a piece of paper was presented to Mr. Stock; Mr. Stock had looked at his books and records and he said, "Yes, this is a claim against McDonnell & Company, but because of the agreements in the case of Mrs. Anna McDonnell and in the case of Mrs. Murphy, where these plaintiffs said, 'I will go last, pay me last, pay everybody else first,'" Mr. Stargatt took that claim and he handled it as a category 3 claim, or as a claim that was not a general claim against the estate; because if he handled it as a general claim against the estate, to get back to this idea of the pie, that part of the estate and the slices of that pie would be cut down very substantially.

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Let's talk about Mrs. Murphy's claim for a minute. I think numbers are important here.

Mrs. Murphy told the receiver in the document that she handed in to the receiver that McDonnell & Company owed her $376,000. You may recall that in this case she says she will take $400,000.

The subordination agreement that she signed, that shows that the value of the securities in her account that she actually subordinated was $342,000 and, of course, somewhat less than what she told the receiver.

Another document we have in this case, which is Plaintiffs' Exhibit 2, refers to even a lesser amount, $282,523, against which there is a debit balance of $59,810, which tells a different story.

We have to reach some kind of conclusion. In this instance, if the jury decides that Mrs. Murphy is entitled to anything at all, this is a way the jury can perhaps be of service to Mr. Stargatt, because when faced with a multiplicity of numbers it becomes a very difficult problem for a man who is a receiver, who is reporting to a court, to act like one.

That is pretty much it by way of introductory comments here. I wanted to give you some idea as to why the receiver acted the way he acted with respect to

these claims.

The plaintiffs in a civil case have what is known as the "burden of proof." I'm sure it's a familiar term we have all heard. The plaintiff has to satisfy you, as the jury, that each element of their case against these defendants, that is, the defendant Mr. Stargatt that I represent and the other defendant in this case, establishes what the law calls the elements of their claim A, B, C and D, all of them, and in a case as complicated as this, I think it's fair to say it's an uphill climb. I'm not saying they can't do it --

MR. BEEBE: May I suggest the charge to the jury on the law is the province of the Court and that counsel not confuse things by putting in h views of it.

THE COURT: I don't think burden of proof --

MR. BEEBE: Ithink "uphill climb" is a different standard than what your Honor will charge.

THE COURT: I overrule your objection.

Comments of counsel are not evidence. They are arguments to you. You may accept them if they commend themselves to you and you may reject them if not.

MR. STEIN: Let me add to that.

What is the defendant required to prove?

The plaintiff has the burden of proof. What does the defendant have to do? Nothing. The receiver in this case, or the defendant in any civil case, doesn't have to prove anything.

I ask you to bear that in mind as you consider the evidence in this case.

One other remark I think is important here: The receiver in law is called upon to answer for the alleged wrongdoing of a man named Murray McDonnell. Murray McDonnell is not a party to this litigation. That's an incontestable fact.

The plaintiffs in this case, as the accusers, are required to prove their accusations against Murray McDonnell. These are the accusations that Murray McDonnell defrauded his mother, his sister, his brother. They have to prove he made statements that were not true and that he didn't say things to them that were important.

The critical aspect of what I just said, that he said things to them that were not important, really boils down to very plain words. The question you have to ask yourself: If Murray told his sister or his mother or his brother the things that they say they should have been told, that is that the company was

in bad financial condition, speaking generally, they would not have made their investment in the company. They somehow would have acted differently.

The law calls that is material. The admissions have got to be material.

What you have been hearing for the last three-plus weeks has been an attempt by the parties to this case to deal with facts, to establish facts.

I think it's well to recall at this point, in any case, what is a fact? I think Mr. Webster has defined a fact as something that has an actual existence. A conversation took place. The fact that the conversation took place is a fact. Who said what to whom? That's a fact.

There is another word in the English language that is very much used. I have used it once or twice this morning. It's an inference. An inference is not a fact. An inference is something that one derives from facts. It's something that we conclude, the why, the wherefore: Why did Mr. Olney ask Mrs. Murphy to lend her account to McDonnell Company? Why did Mrs. Murphy lend her account to McDonnell & Company? That's something you, as jurors, have to conclude. You have to ask yourself based on what you heard in this courtroom

and based on what you know aboutthis case and about the parties relationships to each other, why do people do what they do? That's fairly called an inference.

Another word that lawyers throw around a lot in speeches such as the one I'm making is credibility. We all know what that means. Is it true? Is it false? Is it believable?

When you consider that two people have a conversation, such as Mrs. Murphy has a telephone conversation with Mr. Olney, and two different versions come out of that conversation so that you ask yourself "I don't know who is telling the truth but one thing is for sure, it's hard to believe that these people were even having a conversation with each other," that's something that happens every single moment of your human life. People walk away from a face to face chat or a telephone chat, any kind of communication that is not in writing, and A thinks black and B thinks white. You have to decide, based on circumstances, based on who they are, based on what is at stake, who is telling the truth.

That conversation is, I think, a pretty fair example of what credibility is all about. Let's stop and look at it for a moment.

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We know from Mrs. Murphy's testimony and from Mr. Olney's testimony that they did have a conversation. That's clear. We know that Mr. Olney called up Mrs. Murphy and Mrs. Murphy had been awaiting the call because her brother Murray told her Mr. Olney was going to call her.

At this point what was said during that conversation diverge. It's like a fork in a road. Among other things Mrs. Murphy said that Mr. Olney assured her that in lending her stocks to the company there were no risks and that the paintings on the wall and the furniture in the office and the seats on the New York Exchange or the American Exchange would protect Mrs. Murphy. That's what Mrs. Murphy said in her testimony in this case.

Mr. Olney said he never made statements to that effect. He said he had been in the securities business all of his business life and he knows better than to advise lending securities, particularly securities which are being subordinated to other people's claims, that is something that a person who is in the business, he told us, would never say.

That brings in another concept that I think you have to weigh in addition to credibility and that's

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bias: That is interest in the outcome. One party to that conversation invested a great deal of money in a venture that went sour and that person has lost the money, so she says. The other person in that conversation merely was an employee of the company who doesn't have any stake in the outcome of this case.

When you think about whose version you find the most credible, the bias, or the interest in the outcome, is something that has to be given a very, very careful examination.

Put that conversation under a microscope in your own mind and think about who has a motive, not to lie -- we are not talking about people who deliberately go around and say things that are not true -- but it's the question of A has a conversation with B and each walks away from the conversation. Maybe days or weeks or months later certain events happen to color what somebody said. That's the kind of thing that you have to think about when you think about the Murphy-Olney conversation.

Let's talk about Mrs. Anna McDonnell's claim for a moment.

This is a claim for a very, very substantial amount of money. She says at one point $4 million.

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The first question you have to ask yourself, and the overriding question in the case of Mrs. McDonnell, is did she establish fraud? Did she do that by what the law calls a preponderance of the credible evidence by the weight of the evidence? Did she make this "uphill climb" that she was defrauded here? You have to get more precise here because now I want to address myself to what is evidence in this case.

Mrs. McDonnell does not claim that any fraud is attached to the making of her subordination agreements in 1962 or to 1966. That's not this case. What she claims it is is that in January of 1969 she was defrauded when she was asked again to lend more securities, lend more of her stocks in her account, to the company so that the company could have enough money to comply with the rules and regulations of the stock exchange. She is not suing to get her money back because her expectations were disappointed. This is not a case of what the lawyers call breach of contract. This is not a suit on a promissory note.

Mrs. McDonnell has made the claim in this court that she was victimized, that she was defrauded. Let's see how well that washes against her testimony in this case and against the testimony of Olney.

Mrs. McDonnell admitted she was fully aware of the risks of subordination. She nowhere denied that she had a full awareness of the financial and operating problems of McDonnell & Company in January of '69.

We know because Mrs. McDonnell admitted it in her deposition in this case, which was read into evidence, and Mr. Ford confirmed it when he came here last week, that a certain meeting was held in Mrs. McDonnell's apartment in New York City in 1962, which is when she first agreed to lend her securities to the company. We know that Mr. Ford was there; we know that Mrs. Anna McDonnell was there; and we know that James McDonnell was there; we know that Murray McDonnell was there and we know an accountant by the name of Aaronson was there. We know that Mrs. McDonnell came to this meeting. She had a lawyer and she had her accountant and she had her two sons with her.

Tom Ford recalled very well that he explained to Mrs. McDonnell what a subordination agreement involved and what was the effect. He also ruled that Mrs. McDonnell was an astute, aware person in all areas of her life including financial matters.

Mr. Ford really didn't tell us anything we didn't already know because Mrs. McDonnell admitted on

her own she was aware of the risks involved. She admitted she knew conditions of the firm were worse in 1969 -- this is January of '69. I don't want to confuse those two meetings because it would not be fair to Mrs. McDonnell. What I'm talking about happening happened in 1962 when a meeting took place. Later on, in 1966, Mrs. McDonnell added, signed, another agreement, loaned securities to the firm, and then in 1969 she loaned securities.

I may have combined the two. I'm now talking about something thathappened in 1969, and Tom Ford was not involved in this.

The admissions that Mrs. McDonnell made about what happened in 1969, I think, totally destroy any possibility of fraud here. For example, Mrs. McDonnell said that in 1969 things were worse, "Because I knew things were worse in 1969 or I would not have been asked for more money."

She was asked:

"Q Did you conclude that the reason why they needed additional capital was that conditions had worsened at the firm?

"A Yes, I did."

She said she could not say that Murray did not

give her any information to the contrary. She doesn't recall that Murray did not tell her about operating probability or violation of exchange rules or any of these other things.

She did recall a conversation with her son James at about the time she loaned her securities where she discussed with him the idea of contributing additional funds to her already existing subordinated account and we know what James' attitude was because he wrote her -- this letter was hardly an endorsement of the idea -- and that letter was admitted into evidence.

Talking about jumping from facts to inferences, the facts are that Mrs. McDonnell went to this meeting in 1962 and certain things were explained to her, that she had certain awarenesses in 1969 when the additional deposits of the securities were made. Because Mrs. McDonnell said in her evidence deposition in this case -- lawyers call this an admission -- she admitted that she knew things were worse in 1969. She admitted that the reason why additional capital was needed was that conditions at the firm had worsened. These are facts. These facts cannot be disputed.

I ask you: What are the inferences that

arise from these facts? Why did Mrs. McDonnell continually deposit these securities in her account? What motivated her? Did she know what she was doing? Was the wool pulled over her eyes?

What I say is fairly inferable. What conclusion arises from that? The why, the wherefore, is that Mrs. McDonnell knew what she was doing all along. If you believe that then Mrs. McDonnell has utterly failed to make out a fraud case in this court.

Let's jump for a moment to a related area, also about Mrs. McDonnell's case.

Let's suppose for a minute that Mrs. McDonnell had been given all this terrible information about the company. Let's suppose that all the things that her lawyer said in this courtroom about being victimized, being the pigeon, being victimized by Murray McDonnell, would she have acted any differently? That, again, is an inference. You don't know and I don't know what she would or would not do.

You take the facts and you analyze the facts and what is inferrable from all of that is that the only thing that mattered to Mrs. McDonnell was she was being asked for assistance by her son Murray. This is a lady, don't forget, who was at the time the patriarch

of the McDonnell family and widow of the firm's founder. The firm is in trouble and her son Murray comes to her and asks her to do him a favor, asks her to make her stocks available so that the company can continue to exist.

Mrs. McDonnell really explains her own behavior. She says "Every child had what they wanted if I could give it to them, help them out." Doesn't that really say it all?

No inducements or promises were made to Mrs. McDonnell on the record in this case. She was not induced to contribute additional money to her subordinated account. The explanation comes out of her own mouth, "As T. Murray is my son, I agree to subordinate my account to McDonnell in 1962 and 1965 and as was the case in 1969, to contribute to my already subordinated account."

I think the only inference that arises from all of that, from her own testimony, was that she was motivated to deposit additional securities in her subordinated account becase McDonnell was the family firm and becuase her son Murray was asking her for the money.

Let's jump ahead in months during 1969. We

know that there was a very important meeting at a hotel in New York calledthe Carleton House. This is when the fortunes of the company were plummeting at an increased rate of speed. We know that Paul McDonald, who testified in this case, came to that meeting and that at that point he gave the family what he described in his testimony as "straight dosage." He told them: Those of you -- I'm paraphrasing -- who have been living off this company for many, many years can't expect anything out of this company any more. Things are bad.

That didn't stop Mrs. McDonnell from entering into brand new arrangements in September or October of 1969.

In October of 1969 she had all the facts then and she was motivated the same way towards the latter part of 1969 as she was in the 1962 subordination and the 1966 subordination and the January 1969 subordination. So you have a very, very consistent pattern of events of a mother who is in a position at that time to come to the very much needed assistance of her child who is the chief executive officer of a business that had nurtured this family for more than a half a century.

This was nothing surprising about the way Mrs. Anna McDonnell responded to these requests for

assistance. This is just what a person of her position, her type, would be expected to do. I'm not being critical of this woman, I am just pointing out that there has been a complete failure to prove that she was defrauded. She was not defrauded. She knew exactly what she was doing.

We will shift gears and talk for a moment about Mrs. Murphy's case.

I don't quite know how to defend some of these charges because I don't know whether or not Mrs. Murphy's case is worth $223,000 or $282,000 or $342,000 or $376,000 or $400,000, and Mrs. Murphy doesn't know. All she has done is express a preference for $400,000.

Mrs. Murphy also is trying to prove a fraud case. It's not a case of a person who had a contract with somebody who made a bad deal and lost and is suing the party because that party failed to deliver. Mrs. Murphy is also saying "I was defrauded out of my money."

If you are going to allege fraud you have to be ready to be able to prove what Judge Owen will advise you are the elements of a fraud case. You have to be certain about what happened. The Judge will charge you what a fraud case is in law.

You can't be unsure about the number of conversations you have with the agent of the defrauder. Rick Olney made the phone call at the behest of Murray McDonnell. Mrs. Murphy doesn't know how many conversations she had with Rick Olney. She testified to one or two.

She is uncertain as to the time sequence of signing the documents that were brought to her home by the chauffeur. She is not sure whether it was the next morning or the morning after that. You will recall there was testimony there was a phone conversation. The chauffeur showed up with the papers the next day or the day after.

She is unable to recall when she filled in certain information in the application for approval by the New York Stock Exchange as a subordinated lender.

Is that the way you prove a fraud case?

It may be perfectly normal and natural for a human being to forget certain details about something that happened six years ago, but when you come to court and say "fraud," you better know what was said, where it was said, and how it was said.

You can't come to court and say "Well, maybe there were one or two conversations and maybe it happened the morning or the day after or the next week." I submit

to you that's not what proving fraud is all about.

In the same line Mrs. Murphy testified as to part of the information that she wrote in on her application to the New York Stock Exchange she would have needed the assistance of her husband. She testified that answers, certain answers, were in her handwriting and she referred particularly to question 8 as being "hard to go back there" and 11B, "I would have had to have done with my husband because I could not make up that sentence."

Do you recall her testimony? Here we have a form that's long and complicated. It's put in front of her at 6 or 6:30 in the morning by Murray McDonnell's chauffeur and she signs it and gives it back to him. She does not read it. Mr. Murphy was not with her at the time she signed the documents in the front hall. How did the information such as whatever had to be filled in on line 11B have gotten on there without her husband being with her? Doesn't that tell you at some point prior to the chauffeur coming maybe she was with her husband and maybe she discussed the whole thing? Maybe her version of what happened that morning is not precisely true. Maybe she does not recall as well as a plaintiff in a fraud case has got to recall what happened. Maybe

that says something about her credibility. Maybe that says something about her interest in the outcome. I leave those inferences to you ladies and gentlemen.

On that same subject, I think this is a good time to reconsider -- and I don't want to repeat myself because I do appreciate it's difficult to sit here after all these weeks -- remember the conversation with Rick Olney? You have to decide whether or not Mrs. Murphy's version of the conversation that he said there were no risks, that he said the paintings on the wall and the seats onthe exchange were available to pay her claim -- you have to remember her statements, and you have to remember Mr. Olney's statements that he never said those things to her.

It is well to recall who has an interest in the outcome. It is well to recall also with regard to Mrs. Murphy maybe she is not the naive little sister that she made herself out to be. After all, $150,000 in Mercury, an aggressive fund, loans to her brother, substantial amounts of money.

A moment ago I talked about Mrs. Anna McDonnell and I asked you the question, would Mrs. Anna McDonnell have acted any differently even if she knew that McDonnell & Company was in trouble? You have to

ask yourselves the same question here. What motivated Mrs. Murphy to make this laon to her brother? Was it because Mrs. Murphy was asked by her brother Murray to do Murray and the family firm a favor? Was it because she was acting in a family relationship? These people are not strangers to each other. This is not an arm's length relationship between people. I'm talking now about a brother going in in one instance to a mother and asking for her help. We are talking of a brother going to a sister and asking for help.

Remember also that once Mrs. Murphy made this investment -- she didn't read the document, she did make this investment by lending her securities. This is in January, early February. February 4 of 1969 to be exact. She testified that in late April or early May, the spring of the same year, she heard that the firm was in bad shape and she got this information from her sister-in-law Sandra McDonnell.

She also testified that when she had this information she did not take any steps to terminate her subordination agreement. She did not do anything about it. She did not do anything about trying to get out of these arrangements.

Under these arrangements by giving 100 days'

notice she could have excused herself very nicely from this whole relationship. She did not marry herself financially to McDonnell & Company on February 4, 1969. On February 5, 1969 she could have written a letter to McDonnell & Company:

"Dear Murray, I hereby quit, I am out. I have that right because it says 100 days' notice." And then 100 days would have gone by, three-plus months, sometime into the late spring of the year and she's out. She didn't do it on February 5.

The answer to that was that she didn't know on February 5th that the company was in bad financial condition. She found out according to her own testimony that in late April or early May the company was in bad shape. Well, May 15 came and went, May 30 came and went, June, July and August, right up to September and October when she entered into brand new arrangements. She took no step to end these arrangements. She stayed with it. What does that tell you? That gives rise to the inference that she did not want to get out because she was in there to help the family business. That's why she didn't get out.

What did she do in September or October of 1969? She bought a debenture and she took new

preferred shares of stock in McDonnell & Company in exchange for the stocks that were in her account at the time she made her subordination. More than 100 days passed. She could have during that period upon learning of the company's deteriorating financial condition exercised a right to terminate and say "I want out" but she says "I want in."

Mrs. Murphy failed in one other equally significant area insofar as making out a fraud case. She has not established fraud. She does not know what happened. She has an imperfect recollection. She would not have acted any differently had she known about all of these bad things and she failed to exercise ordinary care, what the law calls reasonable care or ordinary care, in the manner in which she subordinated her account.

She didn't even bother to sign the contract: "I signed it where it said X and I didn't read a word."

Mrs. Murphy's husband suggested perhaps she ought to undertake a more thorough investigation of what Mr. Olney was saying to her. "He said, 'Do you think you should have somebody look into this?' and I said, 'Don't you trust my family?'"

That says it all.

Just as Mrs. Anna McDonnell said, "Every child had what they wanted." Her daughter, Mrs. Murphy, said "Don't you trust my family?"

Because had Mrs. Murphy read the subordination agreement she would have learned that she had agreed to subordinate her claims to those of all other present and future creditors of McDonnell & Company.

Can you imagine? You make a loan to someone and you say, "I am last not only as to any other people who you have to pay back now but in the future."

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That's about as extreme an act of subordination -- I suppose that is the only word for it -- that you can ever run into. All other present and future creditors.

Now, you recall Paul McDonald on the stand. McDonald was given the document called the subordination agreement and asked to make a loan to McDonald & Company. He read the document and he said "That's not for me."

By failing to read that subordination agreement prior to signing it I submit that Mrs. Murphy failed to exercise ordinary care expected of any reasonable investor, because a simple reading of that document would have informed her of the risks of subordinating her account in McDonnell & Company.

Now, let's talk for a moment about James McDonnell's claim of $20,718. These are all individual claims.

Now, if you are going to accuse somebody of fraud you better be able to prove it; you better come to court and you better say, "I had these papers in front of me; I had this conversation," and be almost perfect in your recollection.

Now let's talk about the kind of person James McDonnell appeared to be.

His lawyer has never made the claim in this case, nor could he, that Mr. McDonnell is a pigeon. He

is hardly that.

Mr. McDonnell sat on the witness stand for more than a day. You recall his very informative definitions of concepts such as book value. I learned something from the information that Mr. McDonnell has, and I am sure you all did.

Now, Mr. McDonnell claims that he made an investment in McDonnell & Company during the spring of 1969.

He claims that he was not given the benefit of all the facts; he was defrauded; he wasn't told that the company was in bad financial condition.

He was asked, "What did you know? What did you have in front of you? What kinds of documents did you have?"

He said that he had receiver a lot of papers from Thomas McKay in April of 1969, which included the company's certificate of incorporation, some statements of earlier years of financial condition, profit and loss statements, sources of capital.

There was one document you may remember because it was given out to the jury, and this is called statement of financial condition, October 30, 1968.

James McDonnell just wasn't sure that he had this piece of paper in front of him when he was assembling information in order to decide whether or not he should buy

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$20,000 worth of stock in the company.

Why did Mr. McDonnell equivocate about this one piece of paper? There was no question in his own mind, no problem recalling that he had a batch of other papers. This piece of paper if he admitted he had in front of him would have told him at least three very interesting and important facts about McDonnell & Company as it existed during this period of early 1969. It would have told him that there was a capital problem, because there is a note that to a man like James McDonnell has a lot of meaning; this was one of the notes on the financial statement, the note described there being a net increase in capital of 1.3 million dollars which resulted in the shares of stock of the company.

He would have learned also from a message that his brother Murray wrote "To our valued clients," that they had brought in a new computerized system in order to lessen the inconveniences to customers which are partially due to errors made by overworked personnel, and additionally caused by delays in transferring and receiving securities from banks and other brokers. So he would have known that all was not well in the operations department or in the back office department of McDonnell & Company.

And as we will see in a moment or two when I get

to the debenture claim, he will have learned -- maybe he did learn -- in the early part of 1969 -- because I can't do this justice without quoting it -- that on December 31, 1968, the Series A and Series B registered subordinated debentures were exchanged except for an amount of 80,000 redeemed for cash for a new issue of debentures, Series E, maturing December 31, 1978, with interest at a per annum rate of 2 per cent in excess of the prime rate.

Why didn't Mr. McDonnell clearly recall receiving this document, because this document is shock fall of the kind of information he would rather forget that he had as early as March, April or even May of 1969.

Now, we also know that Mr. McDonnell was a security analyst at one point in his career; we know also that he was a financial analyst with the Ford Motor Company. We know he is not the kind of a man who goes blythely into financial matters without trying to ascertain what are the facts.

Is this the kind of a man who would make an investment in a company without looking into what the company was all about? You're talking about a family company. He has been hearing the name McDonnell & Company for his entire life. There can't be any doubt about that.

I submit that in the case of James McDonnell, as

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in the case of Mr. McDonnell, Mr. Murphy and Mrs. Murphy, it was a matter of coming to the aid of a family business, what was called during the examination a sinking ship, motivated by the most commendable action.

Jim became the branch manager of the Detroit office, because his brother Murray said, "Jim, we need help," and if you can't get help from your family who can you get it from?

Well, Jim said a lot of things when he was on the stand.

I really don't mean any disrespect by calling him Jim, but when you have so many people not only who are plaintiffs in this case but who are principal actors in the whole drama called McDonnell, for purposes of convenience I do that, and I don't mean that as a sign of disrespect.

One of the things I found most troubling and most puzzling was his refusal to admit that he received this document, Exhibit J, the statement of financial condition, when he recalled he received all kinds of harmless documents. Why cast any doubt on that? Did he want to receive this document? Did he want to recall that this document was part of the package that he had during the early part of 1969 which would have told him facts that he said were not available to him?

Now, there are one or two other unpleasant parts of James McDonnell's testimony that must be given consideration in determining whether or not his version of the facts is credible, whether his version is entitled to believability.

You recall he testified that he came to a meeting in New York; his brother Murray was in the hospital; the stock exchange was exercising a very active role at this point because the fortunes of the company had gone downhill very sharply during this period, and Mr. Bishop was there--and this is not Mr. Bishop's version of the conversation I am talking about; it's Mr. James McDonnell's -- Mr. Bishop said,"You have got to get some money into this company."

Mr. McDonnell told his brother Morgan, "Let's lead Mr. Bishop along," the vice president with the stock exchange. "Let's create the impression I am going to come up with some money in this firm."

I wonder if Mr. Bishop believed him. I wonder what Mr. McDonnell's credibility with Mr. Bishop is now after hearing that.

It was just a poker game. "Lets' bluff him." A million dollars. Mislead the vice president of the New York Stock Exchange. It's just a poker game.

You remember his attempts to interest his

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industrialist friend, I think his name was Max Fisher, in acquiring McDonnell & Company.

I asked him: "Did you give Mr. Fisher the benefit of the information you had about McDonnell & Company?"

James McDonnell didn't tell his friend that the ship was sinking or that the house was on fire.

This is really a very serious matter. How do you believe the man? What do you believe and what don't you believe?

What it all boils down to in the case of all these plaintiffs, Jim's case, Mrs. McDonnell's case and Mrs. Murphy's case, an investment in the family business had to be made. Paul McDonald acknowledged that. "Jim did everything in his power to save the firm."

Commendable, but you can't come to the receiver years later and say fraud. If you're going to act out of those kind of motives, highly commendable motives, maybe sometimes you have to take your loss. You can't come around and say, "You didn't tell me this and you didn't tell me that."

James makes some other claim in this case, along with his mother. This is what has been called around here as the debenture claim.

Let's go back to basics for just a minute, and

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I will try not to hold you too much longer.

A debenture is a bond; it's a contract; it's an IOU. You can put all kinds of fancy terms and conditions on it, it's just a plain old IOU. On such and such a date some years in the future I am going to pay you a hundred dollars. That's all it is. When you start saying 100 days from today or three years from today I am going to pay you a hundred dollars if the business is profitable, meaning that the assets exceed the liabilities by 300 per cent, or whatnot, you start putting conditions on it, and sometimes you say, "I'll pay you if creditors A, B, C and D have been paid."

In effect what you do there is, you subordinate the debenture. It's a condition that is placed on the payment of the debenture.

We know that in the late '50s McDonnell & Company went from becoming a group of people who are known in law as partners, to a corporation, and the partners who had their interest in the firm received a debenture that was due ten years later. It's an IOU, saying when all the other creditors are paid we will pay you ten years from the date hereof, and we will pay interest.

We know that one of these debentures was issued by the company to the estate of James Francis McDonnell, Sr.,

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because by then he had passed away.

So we know that for ten years this debenture--it was not a mere hundred dollars or so; it was 318-odd thousand, sat on the estate of James McDonnell.

We know that at some point in the latter part of 1968 in the administering of the estate the executors of the debenture distributed to the trust, because under the will it was supposed to go into the trust, which was for the benefit of a lot of different families.

So we have this debenture in October of 1968 surfacing, and we know that it was given to the three trustees, Murray McDonnell, James McDonnell and Mrs. Anna McDonnell.

Those people keep the debenture and take custody of the debenture, preserve the debenture, and do what has to be done to protect the beneficiaries of the trust.

Now, the claim here is being made -- it's not the clearest claim -- but the claim here is being made that as part of this fraudulent activity practiced by Murray McDonnell against his family, he somehow defrauded them out of this debenture.

Now, Murray was a trustee of this debenture, and this debenture was due on December 31, 1968. So that what the plaintiffs are saying, as I understand them, is that

on December 31, 1968, something should have happened. The $318,000 should have been paid to the trustees. But Murray McDonnell, as a co-trustee in late December knew the company couldn't afford to part with $318,000, that something had to be done, and the claim is that Murray McDonnell, operating without the consent of the two other trustees, or, at least one of them, took that debenture and substituted for it a debenture similar but not payable for another ten years.

What the note in the financial statement says is a Series E debenture maturing December 31, 1978.

I think the word "roll over" was used during the early part of this trial. A claim is being made that Murray without the consent of the other trustees rolled it over and that worked a fraud on someone.

You will have to examine for yourselves and in your own minds where the fraud was.

You have got to remember the facts; you have got to remember that the trustee plaintiffs in this case, Mrs. Anna McDonnell and James McDonnell, have the burden of proving that the consent of the required number of trustees to substitute a Series E bond for the Series B bond was never given.

Now, they have got to show, someone has got to show

Murray did it; Mrs. McDonnell did not consent; James McDonnell did not consent, because under the trust instrument in this case it takes two trustees to make a decision that can bind the trust.

Now, James McDonnell says "I didn't consent."

There is no question but that one trustee, Murray McDonnell, consented. The question, and the $64 question in this frame is: What, if anything, did Mrs. McDonnell do or not do? Did she consent or did she not consent? All she said is that she doesn't remember whether Murray advised her that he was attempting to roll over a Series B bond for a Series E bond; and she said also that she can't even state with certainty that the trustee ever even authorized the substitution.

She also said that from time to time the trustees did business orally; decisions had to be made about investing assets of the trust, perhaps making payments and doing other things that involved the activities of the trust.

Can you prove fraud on such a thin reed? One trustee says "I did it, and I was authorized to do it"; and the other trustee says "I never gave you authority," and the third trustee says "I don't remember whether Murray ever advised me that he was going to do anything to roll over the bond, and I can't even state with certainty whether the trustees

ever even authorized substitution."

I don't know; you don't know; but it's the plaintiff's uphill climb to show that some wrongdoing was done with respect to this trust.

Now, I will leave for Judge Conner the explanation--

THE COURT: Owen. Although I was confirmed with Judge Conner the same day.

MR. STEIN: I'm sorry. Excuse me.

Now, I will leave for Judge Owen the job of explaining how this debenture fits in here, whether or not there was really any fraud that can be placed at the doorstep of the receiver, because if all these terrible things that Murray McDonnell did were actually done, that is, if he rolled over this debenture without getting his mother's and his brother's permission to do it, Murray McDonnell is a trustee, they know where to find him if they wanted to find him. You have got to lay this at the doorstep of the receiver because the receiver is the company. That is a critical element; it could be a fatal element in this whole claim on the trustee.

Bear in mind also with regard to this debenture claim, this $318,000, something should have happened on December 31, 1968. Nothing happened. You have the epitomy of the responsible trustee, James McDonnell, who

testified that he had a complete inventory, in detail of what was in the trust.

You have James McDonnell, Anna McDonnell and Murray McDonnell with responsibilities to beneficiaries of this trust, for all the assets of the trust, including the $318,000.

Why didn't somebody step forward and say, "December 31st, 1968. Here's my debenture. Where's my money?" Particularly wher one of these trustees described the way he viewed his role in these terms:

When a member of your family, such as your mother or father dies, whatever is left in the way of assets or money ultimately passes on to the trustees as a custodian, as a person who guards these things. It is an extremely important duty imposed upon , because you have many people whom you are responsible to; it is the highest responsibility that a man ever gets, really, to become a trustee; it is the most responsible position."

And I believe that James McDonnell took his position very responsibly. I believe that.

Why, for the life of me didn't he on December 31st or January 1st or January 2nd if January 1st was a holiday, come forward and claim what belonged to the trust? Because he knew if he took that money out that would have been the

beginning of the end. The company needed the money for capital just as they need Anna's account, just as they needed Mrs. Murphy's account, and just as they were later to need James McDonnell's investing in the company.

Mr. McDonnell says years later, with the benefit of hindsight, "I was delinquent."

You have got to come to your own conclusion what motivated him. Was he delinquent? Maybe he is being a little too hard on himself. Maybe he knew what he was going all along, and he left that debenture in there because he intended to leave that debenture in there.

Remember also that we have gotten nine months into 1969 before Mr. McDonnell, the responsible trustee that he was, even made what might loosely be termed a demand. On September 12th a letter was written. The letter is in evidence in this case. No demand is even made for cash in that letter. It is the kind of letter you write just for the record - "Remember me when you get around to making payments here, I've got a pretty good claim.

I say to you, ladies and gentlemen, that the inference here is the clearest inference in this entire case. Nothing was done from January to September to come forward to claim that money because James fully intended that that money be with the company.

There are two very solid grounds why that claim should not be granted. There is no proof that anybody was defrauded out of anything; there is no proof that Murray McDonnell in his capacity as president or chief executive officer of McDonnell, did anything wrong. If he did something wrong he did it in his capacity of James Francis McDonnell, and the wrongdoing was visited upon the beneficiaries for whom he was responsible.

And then there is the conduct of James McDonnell, and it is that conduct that was deliberately designed to help preserve and conserve what was left of McDonnell & Company.

One final thing: The first day that law students walk into a law school, I believe - at least it certainly happened in my case - you get a lecture on common sense. You are told by the dean of the law school or whoever is responsible for shepherding first year law students, in whatever law school you go to - and I can't believe it differs from one law school to another - don't leave your common sense outside, because you are going to study law, and you are going to study law cases, which are breakdowns in human relationships, which are disputes. A courtroom is really an alternative to what was in former times just an arena where people actually went at each other with weapons

and swords.

Don't leave your common sense outside.

I say the same thing because I think that message, I like to think that that message got through to me.

I know you are dealing with very complex legal and factual matters. It has been a very long trial; a lot of proof came in, matters that were more complicated than even the lawyers were able to understand at times. It is for you to exercise your common sense as to who these people are, how they related to each other, why they did what they did when they did it. That's the case to decidin the case.

The law is a great aid; the rules that have been laid down over the centuries, going back to the common law; we have statutes in this country, we have rules that come out of courts all over the country - these are great guideposts, but there is no substitute even in a very complicated case for common sense.

Thank you very much.

THE COURT: Ladies and gentlemen, we will stand in recess until ten minutes of 2.

(Recess to 1:50 P.M.)

AFTERNOON SESSION
1:50 p.m.

(In open court; jury in box)

THE COURT: Mr. Brooks.

MR. BROOKS: Ladies and gentlemen of the jury:

As I sat here and listened to my brother Stein talk with you this morning I could not help but wonder whether we had fallen into the middle not of a family squabble but in the middle of an alternative to a family squabble.

We are now in the fourth week of this trial in a case in which the plaintiffs charge the stock exchange with failure to regulate. We have seen an awful lot of regulation, all these documents, all this testimony about what happened to the New York Stock Exchange and to McDonnell & Company.

Your turn will come to examine all these documents and to consider the testimony. I'm sure you will approach that with a mixed amount of blessing.

Since the exchange has generated most of these documents and most of the testimony, I feel a particular responsibility to try to pull it all together and assist you in your deliberations. When I am done

my colleague, Mr. Beebe, no doubt will in his way attempt to assist you in an entirely different direction. Then it will be your turn, guided by his Honor's instructions, to arrive at a decision.

I suggest to you that on the evidence that is before you that decision can only be that the stock exchange has no responsibility to these McDonnells for their investment in McDonnell & Company.

You will recall Mr. Beebe's opening speech to you, the first day of the trial. He told you this was just a case of failure to tell the truth and that that was not fair.

Then he went on to tell you that James McDonnell was just an automobile dealer from Detroit and Margaret Mary was just a naive sister from New Jersey with five kids. He forgot to tell you that she didn't like to read, but maybe that's what he meant when he said that an Alice in Wonderland world would unfold before you in this courtroom.

I hope you also will recall what I told you that first day. I said, listen to the evidence, evaluate the motive and the bias of the witness, and ask yourself: Is the witness telling you in the trial the same thing the witness said in 1968, in 1969?

That's important, ladies and gentlemen, because it's also not fair to try to stick someone else with your own bill. You don't do that and I don't do that. We all pay our own way. We take the good times with the bad times.

During the weeks this case has taken, did you ever get the feeling that somebody was missing? I'm talking about Murray and Morgan, of course. If the plaintiffs' story is really true why aren't they in here as defendants?

The plaintiffs' story has not been anything at all like Alice in Wonderland. It's been like Little Red Riding Hood without the wolf.

The claim against my client is that it didn't properly regulate the firm of McDonnell & Company. Mr. Beebe and I both agree that the stock exchange had a duty to regulate McDonnell & Company. And I think we both agree that the exchange did regulate McDonnell & Company. If it didn't, where did all this paper come from? Where did all this testimony come from about what was done? It seems that somebody was writing a memo or having a telephone call almost every day in those two years.

Plaintiffs contend not that the stock

exchange didn't regulate it properly -- they can't contend that -- but they're contending that the stock exchange didn't do it right. They know the right way and they want to tell you that they know it better than those good men who were at the helm of the stock exchange, who were on the hot seat and had to make those decisions in 1968 and 1969, when there were 50,000 customer accounts in McDonnell & Company and it was their job to protect them.

Plaintiffs make this argument because they would like to find some deep pocket other than Murray's and Morgan's to get back their lost investment. They're like the football fans that bet on the game and lost and on Monday morning they sit around grousing why the quarterback didn't throw a pass on that last play instead of giving the ball to the fullback and have him get tackled on the goal.

But that's not what your inquiry will be, ladies and gentlemen, because I think you should ask yourselves: Are those good men the Schuettes and Spieses and McElroys the financial cops -- and Mr. Bishop who made the decisions -- did they act with reason and with good faith to fulfill their duty to the public as they knew it to be in 1968 and 1969?

Remember, it's the plaintiffs' job to convince you that they did not so act and that in not acting that way the plaintiffs were injured by their failure to act in that way.

I suppose that among the regulatory claims of the plaintiffs is that rollover of the debenture that Mr. STein spoke with you about. I think it's easy to see that the principal architect of that claim is James McDonnell, the prudent trustee. James was the president of so many corporations that when he made his application to become an allied member of the stock exchange he forgot a couple; being the prudent trustee he was, he quickly sent in a supplemental letter.

We also know that James worked at McDonnell & Company in 1945 after coming out of the United States Army as a captain at the age of 27.

James had been a securities analyst at the Bank of New York before the war and it was natural that he would go to work for McDonnell & Company and help out the family firm.

James F. McDonnell, Sr., did not think that James cut the mustard and he would not pay him out of the firm revenues. James went off in a huff to Detroit to make his own way working for Henry Ford, and Murray,

Morgan and Sean ended up with the firm, and ever since then James had an understandable atipathy to McDonnell & Company, to investments in it, to Wall Street, to the New York Stock Exchange which might explain this lawsuit.

Now, James' claim to the liquidator contends that James got all kinds of false and misleading information when he made his investment in voting common stock. James said it's all false and misleading. That's the last we heard.

So here we have in evidence a whole lot of financial information (indicating) about McDonnell & Company. Nobody said what is wrong with it.

Then there was also that financial statement. Do you recall theone that Mr. Stein spoke to you about this morning? You have seen that before. I disagree, I think, with Mr. Stein's analysis of when James got this because, as you will recall, he and I had a long go around round the bush as to when he got this. I think it became pretty clear when he answered those interrogatories that we read into the record back when James was on the stand.

That was a written statement, sworn under oath, that James got this misleading financial

statement on February 25. He had a meeting with brother Morgan. I think that's important because of those two footnotes that Mr. Stein mentioned to you this morning and because of brother Murray's message to valued customers where he said "Boy, we have a lot of paper work and we know we have some errors, and we know we are causing inconvenience; just stick with us; we are trying to convert to our new record keeping system."

I think these things are important because they go to this claim about the debenture.

Right in this note here, if James' sworn interrogatory was truthful, James would have gotten this statement on February 25 and this debenture had matured a month and a half earlier. Despite the fact that James told us he kept a careful inventory of all the assets in the trust and he made that inventory in the fall of 1968, he claims he didn't read it.

But you will recall the year before in September when Murray had raised the possibility of his sister Genevieve subordinating her account at McDonnell, James quickly found a 1967 financial statement. He wrote a letter to Murray September 20, 1968, which is Plaintiffs' Exhibit W, which gave Murray a quick lesson on how to analyze financial statements when somebody in

the family was going to consider putting money in the firm.

He told Murray, "As I understand, you have an awful lot of indebtedness coming due on December 31, 1968."

Maybe James didn't realize part of that indebtedness was one of those assets in the inventory he just made. Maybe he didn't remember that.

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Now, what role does the exchange play in this maneuver about rolling over a debenture? I am not going over the points Mr. Stein dealt with this morning about Mrs. McDonnell not really recalling whether or not she agreed to roll over the debenture or not. I think those arguments apply equally when you consider this debenture to the claim against my client.

I want to just concentrate on what role the stock exchange is supposed to play here and why they are asked to pick up the tab for somebody's oversight, maybe.

We have heard some testimony that the stock exchange considers the underlying trust instrument when a trust wants to make a capital investment in a member firm. We have seen one trust where the exchange examined that instrument and they said, "No, no, Manufacturers Hanover Trust Company, no, no, Mrs. Murray McDonnell, you can't put that one and a half million dollars in trust in McDonnell & Company because we are not quite sure that your trust instrument authorizes that, so get something else, we can't consider that."

But that wasn't the case with this debenture, because we are all perfectly clear that the will of James Francis McDonnell, the founder of McDonnell & Company, authorized in no uncertain terms that this debenture remain

in the firm as capital so that the firm could be run by Mr. McDonnell's sons.

Now I want to make clear to you that there is no contention that the stock exchange did not properly decide that way back in 1958, or whenever that debenture was created, that it wasn't a proper investment in McDonnell & Company. It was indeed.

Now, I suppose what the claim really is is that the exchange should have known that T. Murray McDonnell when he rolled over that debenture didn't have the proper authorization. We don't even know that today because Mrs. McDonnell can't recall.

Early on in this trial you had occasion to take a look at this financial statement by Lybrand Ross. Brothers & Montgomery, one of the big eight accounting firms.

Mr. McElroy told you that when Lybrand Ross started off on their audit on October 31, 1968, of McDonnell & Company, they would have come in there with a squad of about 450 accountants to check out all the books and records and the underlying paper work. We know that they were there from October 31st until about January 15th. Mr. Beebe probably will argue that that was too long; they should have been gone a couple of weeks earlier. I don't think that is so important, though. I think the point is

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that they came up with a certified report. This is a summary of it which was prepared and made readable to customers.

We know that Mr. McKay sent a letter to the stock exchange saying this went out to customers with their February account statements, so if James didn't get it from brother Morgan on February 25th he must have gotten it in at least one of those 20 account statements that he received for him and the two trusts of each of his children. Mrs. Anna McDonnell must have gotten it in one of those account statements that she had in six or seven accounts what Mr. Olney told you about in McDonnell & Company.

The important thing is that in this audit and in the report that Lybrand prepared they certified to the stock exchange or any other reader, including James, that this subordinated debenture, B debenture, had been exchanged for a Series E debenture.

Mr. McElroy told you, by God, he and those two other examiners who were at McDonnell from February to April had enough to do without checking up on these 200 guys from Lybrand Ross who spent three months in there, and the exchange believed that it was entitled to accept the certified report of Lybrand.

So there was never any suspicion at the stock

exchange that anything improper had taken place with respect to the exchange of the debentures.

There is no evidence whatsoever that Murray McDonnell was urged or told the exchange anything about the terms of the exchange. It was perfectly natural that where the will of James F. McDonnell, the founder of the firm, had said that capital can stay in the firm, that that capital did stay in the firm; and when the first debenture expired at the end of ten years, it was exchanged for another ten-year debenture.

Now, normally you think when someone is aggrieved they will complain, they will try to do something about it. But Mrs. Anna McDonnell testified that she never told the exchange anything about this debenture.

And James McDonnell testified to the same thing.

Now they must have known the exchange could help if the money was still there.

Now Mr. Stein pointed out that the trustees also never made a demand for this debenture.

Mrs. McDonnell had received on December 5, 1968. She signed a receipt for it, which is in evidence, and James took that carefully in to her. But yet when he came to write that September 12, 1969, letter, which we are not sure when it was sent, he sent it to the firm of McDonnell

& Company and he sent a lot of copies to a lot of people. He sent it to Lybrand Ross, to Shearman & Sterling, attention Tom Ford; Mr. Paul McDonald, and all the board members of McDonnell. He didn't send it to the stock exchange.

Do you remember that wire message that went into evidence dated October 23, 1969? James wired Rick Olney in the New York office and he said, "I don't like this form that Tom Ford has prepared to replace that Series B debenture, and if you don't come up with a better form I might have to demand payment."

He hadn't made a demand yet in October. I guess when he did make a demand it was too late.

Now, if someone knows that a wrong is worked on him, and if they wait until they know it is too late, is it fair, is it fair to try to sock the guy who you didn't tell, and who could have helped you for your loss?

Keep in mind, ladies and gentlemen, the exchange knew none of this, and it was entirely reasonable and it was entirely in good faith that we didn't know it. They were justified in relying on the auditors which are part of the regulatory process under the exchange's rules.

The demand in this case that the exchange stand the loss of the debenture has nothing to do with regulation.

sl h6

It is a claim to indemnify the trustees for their decision to stick with McDonnell & Company. They stuck with it then and they should stick with it today.

Now let's move on to all this other testimony that we have heard about it, capital ratios and rule enforcement, and take a look at that.

Plaintiffs would like to make it sound so simple. They use phrases like you enforce your rules or you don't. The rules have to be applied equally to all people."

Well, things weren't like that. Not all people were the same, and there were times the rules did not provide a response for a particular set of facts. The world wasn't that simple, particularly in 1968 and 1969. This was the time of the paper work crunch.

Rule 345, which is the capital rule, is about 40 pages long, and it tries to define as best you can in any written rule an artificial concept of liquidity which Mr. Bishop and I think Mr. McElroy testified, that a brokerage firm had to have so much in its assets availability in 30 days.

Now, what's available in 30 days and what's not available in 30 days is often, I think, as we have seen, a question of somebody's judgment.

Keep in mind that this concept of liquidity has

nothing to do with the value of the business. That's the net worth of the business, and that has never been questioned here. It has never been questioned that McDonnell & Company had lots of net worth. All we are talking about is this artificial concept of liquidity, for people who want to get the money out in 30 days.

Mr. McElroy told us that not only did we have a paper work crunch in 1968 and 1969 but that this paper work crunch was causing all sorts of problems for interpretation of the exchange's capital rule. Judgments had to be made, and Mr. Bishop primarily was the one who had to make them; and he sat here for a couple of days and tried to explain what those judgments were, why they were made, what the considerations were one way, what the considerations were the other way.

Now, I suppose somebody who knew what he was talking about might say, well, maybe we could have made one of those decisions the other way. But I don't think anybody could say that those decisions were not rationally based, or were not made in good faith, with a sincere attempt to help protect the public interest.

Now before you talk about enforcing your rules, before you can say the exchange dropped the ball, you have to say that the exchange knew about a violation of

the rule, before you can say it has any duty.

Now, the most obvious case is the time lag in the reporting process for these brokerage firms.

Lybrand Ross went into McDonnell & Company on October 31, 1968, and they didn't have a report ready until January 15th. The exchange didn't have an opportunity to properly analyze it until about a week or so later. And then they came up with a capital ratio for October 31, 1968, and that would didn't between October 31, 1968, and the middle of January somebody wasn't doing something about a violation, because nobody knew about that violation yet. And you can't say the exchange had any duty to do anything until it knew or until it reasonably should have known. That's only fair.

And then what happens when you determine that a rule has been violated, because there was a determination that a rule was violated when that audit report came in in January, 1969. What should an exchange do? Its rule has been violated. The rule doesn't say what happens next. Rule 325 doesn't say what happens when a firm violates the capital rule.

I think it is clear from the exchange's practice, the first thing that is done is to correct the violation because you have to protect those public customers who might

want thosesecurities or their case in 30 days, under that liquidity rule.

Then after you correct the violation the next question under the practice that we have seen, how do we make sure that doesn't happen again so we can provide some future protection? And then what do you do about the violation of the rules?

Now, there are procedures to discipline rule violators; there are all kinds of disciplinary techniques to use. You can restrict a firm; you can fine a firm; you can suspend a firm. It doesn't make too much sense to fine a firm that is having a capital problem. That's not too good for the public customers. You need more liquid cash in the till.

So another choice comes to a responsible regulator. How do you best, under the facts that you have, act to prevent a future violation of the rule and get some respect for your rules?

Put yourself in the place of the Schuettes and the McElroys and the Spieses and the Bishops. I think it is plain to see that these men acted as they saw their duty, and they did a good job. It is a reasonable job in good faith.

Now, let's some of these episodes that we have heard so much about.

Lettered stock: is lettered stock eligible for capital credit? Wall, Mr. Elroy says yes, sometimes when you can demonstrate some value. Somebody has got to make a judgment.

A firm comes in with a set of facts, and they say "We can demonstrate some value for this lettered stock, and you ought to give us capital credit."

The exchange makes a study of these facts and comes to a decision.

Income tax refunds: The general rule is that you have got to be able to show you are able to get it in 30 days. You can do it in a lot of ways, and maybe some ways nobody has even thought of getting it. Somebody has got to decide whether you could or you couldn't get it, demonstrate you could get it in 30 days.

McDonnell was the rights firm on the New York Stock Exchange, just about the only rights firm. It was what we call a specialist.

Now, they had these positions in rights, and they had to get treated one way or another under the capital rule.

The exchange batted it back and forth and decided that where there was a conflict of the specialist's rule and the capital rules, and there was absolutely no risk,

because a liability on one side was hedged against an asset on the other side, they made a judgment and said that shouldn't be charged as a capital debt; it should not be subtracted from the capital. That was consistent, as Mr. Bishop told you, with prior practice - the Studebaker Worthington rights offering; it was even consistent with the AT&T rights offering that has been going on recently.

And this stock record problem that has come up: Mr. McElroy told you that back in the old days when you didn't have paper work crunches and had normally high volume, you didn't have stock record differences, and Rule 325 was silent about what a stock record difference was and how you treated it.

But here they were coming down the pike in 1968 and 1969. The rule didn't say what to do, and somebody had to decide, and they did decide. And it was reasonable that they were not charged because stock record differences usually evaporated with research; it took a little work. They were not real liabilities; they were just a little confusing.

Now we have heard about a sale of the Mutual Fund Management Company. I don't think there is any proof that this was given capital credit, and I don't know whether it was or not, but we have seen a guarantee by another

member firm that those proceeds would be evidenced by a subordinated loan if they were needed and if the stock exchange want to give capital credit to that subordinated loan it would be the same as giving a capital credit to Mrs. Murphy's subordinated loan, even better, because you had a member firm on the hook, someone you had jurisdiction over.

Now the story starts, I guess, in 1968 when that 1967 audit comes in, a little late again. These audits for all firms came in a little late in these two years. What was the exchange supposed to do about it? It is the auditors who were doing the job, and if they had any problems, their personnel was strapped, the exchange can't do the audit itself. It has only got three examiners where Lybrand Ross has 150.

In comes the audit. The capital is all right in February, 1968, but there are some record keeping problems. Maybe they are not any different than the other firms on the street, but these guys at McDonnell & Company aren't paying attention to the stock exchange staff.

So Mr. Bishop slaps on some restrictions and it gets a lot of attention. He has got T. Murray McDonnell over there two or three times in a couple of weeks, and McKay, and he has got letters going back and forth, and

in about a month he is satisfied not that the situation is any different but he is satisfied with what the firm is doing in any event was the right thing, and now the stock exchange knows about it, and it has got someone paying attention to it; the restrictions are lifted; the firm is told "Take it easy, fellows, be cautious or we may have to put those restrictions on."

The firm is put on a monthly reporting system; it has got to file these special operations questionnaires every month so the exchange can keep track and see that this problem doesn't get out of hand.

pgrl

Mr. Schuette testified that the problems seemed to be remedying themselves in late 1968. Nevertheless, McDonnell put some of its own restrictions on and cut down the number of its trades.

Lybrand started their audit on October 31, 1968. We don't know what they were going to find in that fall of 1968.

Then, around November, Mr. Bishop heard some gossip. You know, on Wall Street you hear more gossip than almost any other place, even more than ladies' clubs or the Elks club. Gossip is what makes Wall Street go round and round.

Mr. Bishop heard that seven producers were leaving. He was worried that maybe management was getting a little weak at McDonnell. So he asked Mr. Schuette to take a look and see if they were any worse than they were when they put those restrictions back in March.

Mr. Schuette did take a look and he came up with a report to Mr. Bishop. That's Exhibit 35A. He has a lot of schedules attached. Do you know what those schedules show? They don't show the situation is any worse. They show it was a little better.

There is a whole column of capital computations in this exhibit. They're all good ones.

They're all considerable under that magic 2000 per cent net capital.

Mr. Schuette writes a little note to Mr. Bishop down here and suggests that in view of his findings "we ought to wait and see how the audit turns out because the auditors are in there working" -- and that's reasonable, because when you consider restricting a firm you are considering telling the firm it can't make as much money as it would like to, it can't work as hard as it would like to.

It's like telling the working man instead of working an eight-hour day he can only work a seven-hour day, that is, he can only earn seven hours' pay. You don't jump into these things. You give it some thought and wait until you are sure, until you have some good evidence. That's what Mr. Bishop and Mr. Schuette agreed to do in November.

That conclusion was confirmed when they got the December special operations questionnaire. It came in in early January, again illustrating the time lag in brokerage reporting, but it showed figures for November, for Decemb er, and for the prior March. Mr. Bishop testified that those figures were all good figures. There was not any cause for alarm.

pgr3

All during this time in 1968 McDonnell & Company was reporting capital ratios to the stock exchange. You will recall that ratio is above 2000 per cent and if it's scrutinized and found to be really above 2000 per cent it's a violation of the exchange rules.

I would like to read very quickly what the evidence shows about the capital ratios with respect to McDonnell & Company in 1968.

March 18, 1403. April 25, 1434. May 29, 1335. June 27, 1743. June 27, 1873. July 26, 1590. August 26, 1354. August 30, 1414. September 27, 1369. November 4, 1341. November 11, 1356. November 18, 1277. November 25; 1352. December 2, 1598. December 30, 1659. January 6, 1753.

Not until January 27 is it that the exchange learns McDonnell is really in violation of the exchange's capital rule. Back then as of October 31, 1968, the auditors provided information for the exchange to calculate that. The exchange had gotten a little advance rumbling of this, maybe January 10 or so, but you can't act on rumbling. You have to have the figures. The response is going to have an important effect. You have to knowwhere you are going and how far you are going to go.

pgr4

There has been a lot of chatter about this report being late too. It was. The firm got an extension. When they got an extension on December 23, 1968, it was granted only on the assurance of Messrs. Lybrand Ross in their letter which is Exhibit DD that McDonnell & Company was meeting capital requirements as of October 31, 1968, and as of December 23, 1968.

It was reasonable to grant an extension on that assurance from an accounting firm like Messrs. Lybrand, Ross. I don't think the exchange can be faulted at all.

When this audit was examined it showed a ratio of about 2700 per cent. That's 700 above the 2000. What they needed was about $500,000 improvement in that capital ratio to get it down to 2000.

That was not good enough because they wanted to make sure that this would not be a problem firm again, so Mr. Bishop told the fellows from McDonnell at a meeting on January 29 "You guys improve your capital ratio by $500,000 in two days and in about ten or fifteen more days you get in another $2 million of improvement to bring yourself below 1500 per cent so I don't have to worry about you any more."

"No problem," says McDonnell & Company.

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On January 30, 1969 -- it came in a day early -- they didn't get just $500,000 additional, they came in with $950,000 of net capital. That's a 30 per cent reduction on market value, so the market value was about $1,300,000 of additional capital to apply to their requirement under the net capital rule. Where did they get that?

The exchange learns for the first time on January 30 that Mrs. Anna McDonnell, Mr. Murray McDonnell's mother, has increased her already existed subordinating account in the amount roughly of $1,100,000; Murray's wife Marjorie has put another $222,000 into her already subordinated account.

After this is done the best analysis of the exchange: Here's a firm that is $450,000 to the good, and under the capital rule it's a firm that's promising it's going to get in that other $2 million on timely schedule.

They did. The firm did bring in that other $2 million and it did it in part from Mrs. Murphy's subordination, among other things.

One of Mrs. Murphy's claims is that she didn't know there was a capital violation. We know that all of her subordination documents, the subordination agreement, the financial supplement, application for approval to the

stock exchange, which came in much later -- you will recall she was approved sometime in March -- all of this documentation was signed on February 4. The firm of McDonnell & Company was not in capital violation on February 4. It had not been since January 30th, when Mrs. McDonnell and Murray's wife put in their funds to put McDonnell $450,000 to the good.

Some of this money that did come in on schedule later, the extra $2 million, consisted of funds from a trust, which I have mentioned before, the Manufacturers Hanover Marjorie F. McDonnell trust, which Mr. Bishop described as the Flannigan trust.

About a million and a half dollars in market value was brought in by McDonnell & Company. Manufacturers Hanover was willing. Marjorie F. McDonnell was willing. The stock exchange said "No, no. We don't like that agreement. We are not sure that it authorizes this kind of investment."

It's like a trust provides that you can only invest trust funds in government obligations. If somebody wants to buy common stock, it's not authorized. The stock exchange didn't think it was authorized so it sent out and said "You have to come in with something more."

I think this is important, ladies and gentlemen, because it shows that the exchange was calling them as it sees them. It's not just, as the plaintiffs have argued, taking anything it can get and throwing it into McDonnell & Company to keep it going. It's calling it as it sees it and it's throwing back a million and a half dollars.

This was made up very quickly. Murray McDonnell, as Mr. Schuette said, went out and put in $600,000 of temporary capital on March 10. Murray in April and May, as we have seen in exhibits and notes, went across the street to Citibank and borrowed $1 million at one shot and $650,000 at another. So here we have roughly $2 million of Murray McDonnell money in cash, no hairpin on that, coming in in the spring of 1969 to replace the Manufacturers Hanover money that the stock exchange rejected.

"Now," say the plaintiffs, "that might take care of the capital problem, but this is a firm that has paperwork problems. What are you doing about those paperwork problems that are causing the capital problems?"

Well, the stock exchange didn't even have to do anything about that. Their meeting was on

the 29th. On the 28th of January McDonnell & Company sent a letter to the stock exchange, Exhibit BB1. This letter first analyzed the capital developments that had occurred between October and January 29. It showed that there was one partner or one capital contributor who was leaving with an amount of $405,000 and that there had been other withdrawals and there also had been increased in capital. When you net them all out.

McDonnell & Company certified to the exchange that they had improved their capital over what it was in October by $845,000. So the exchange was not concerned about that partner that was leaving, the capital contributor.

What are they doing here about paperwork problems?

This is the letter in which McDonnell & Company adopted what we call "self imposed" restrictions. Why did they do that? I think it's easy to say. This was a proud firm. The firm is under restrictions and doesn't have as easy a time to keep employees. They wanted to do it themselves, clean up their own house, and they said what they would do here, and it turned out they were doing the same thing that the exchange would

have had them do; they noted that since April, April of '68, they had been trying to convert to an IBM 360-40 automatic data keeping process. While they were trying to convert they were still running a parallel system so that if they had any mistakes on the IBM they still had their basic records, their old RCI system. They say they were running parallel tests on the old system. "We have added 143 employees to our operation staff. We started a cyclical box count."

You will recall there was a lot of talk about McDonnell not counting box securities. Here they are starting to do that. Mr. Bishop explained how a cyclical box count would improve the record keeping system of the firm. They referred to their July 1, 1968 small ticket restrictions and said "We are keeping those."

They had hired the firm of McKinsey & Company, one of these fancy management companies, to give them some counseling on how better they could handle these and their getting in some top personnel to help with the record keeping. They have Mr. Jaeger, a CPA, Mr. Cassidy, formerly vice president and director of the First Boston Company, David Rome, CPA.

So both in the capital and in the record

keeping area this appears to be a firm that is really pulling up its socks. They're not suffering from anything but just a little too much business. Isn't that something we would all like to suffer from?

I suppose the question could be raised: Should the exchange have shut this firm down in January of 1969 when it got this audit report from Lybrand? It was in violationof the rules. If it did, then Mrs. Murphy and Anna McDonnell could not have put in any subordinated money because the firm would not be there. It's as simply as pie.

Well, let's take a look at that.

This is a firm that had a $16 million net worth, $16 million in value.

It was a firm that had a willingness to adopt restrictions before the exchange even told it to do it, and to hire consultant firms and new personnel to clear up its back office problems. It was a firm that had a quick responsiveness to capital problems and a seemingly inexhaustible supply of capital. The problem was it just needed to slow down a little bit.

It had always been a highly profitable firm. In 1967 it made over a million dollars. The first eight months of 1968 it was making up to $800,000 in profits.

And it did have a falling off. Mr. Beebe put in a document yesterday, Exhibit 98, which showed that for the year ended 1968 when they made the report in March to the stock exchange the profit tailed off to $400,000 instead of the $1 million of the year before. The stock exchange didn't know that in January. 400,000 was not so bad for this time either.

You have to keep in mind that those are profits after we paid Murray's salary and Morgan's salary, and James McDonnell, III's salary for his tour over there in the Paris office. We paid interest on these debentures which are getting a higher rate because they're owned by insiders under the exchange's rules, paid interest to these subordinated account holders at those same high rates of interest, and all the other things that preferred stockholders were entitled to.

Ladies and gentlemen, rather than being a firm that the exchange should have shut down in 1969 I submit to you that if the exchange had done that it would have been the height of irresponsible regulation. The capital rule did not authorize it.

The exchange did have a constitutional provision which provided you could shut a firm down overnight if you could show it was insolvent. How can

you do that with $16 million of net worth? Or if you could show that it could not meet its engagements, that means pay its bills -- nobody said McDonnell could not pay its bills.

Here was a firm with 50,000 customers' accounts, with 26 branch offices throughout this country and some abroad. What is going to happen to those accounts if you close the doors of that firm? Who is going to get out the securities and the money?

Well, you will need some cash to pay employees, to straighten out some of those records. To deliver out 50,000 accounts, whose assets are those funds going to come from? The plaintiffs.

The other capital contributors to McDonnell & Company, Mrs. McDonnell, whose account is already subordinated to the tune of $555,000, sister Anne, what is going to happen if this firm were shut down?

Ladies and gentlemen, if this firm were shut down by the stock exchange can you imagine the lawsuit that we would have in this court brought by all the McDonnells, not just two of them, but all of them? Tom Ford would be the lawyer and he would be standing up in this court on behalf of Murray and his wife and Morgan and Anne, Anne Ford Johnson, and Anna McDonnell, the

estate of Sean McDonnell and the trustees who own those debentures, and the dollar claims for what they lost would be astronomical, and then they claim they lost opportunity because the stock exchange chopped down a perfectly good money tree that they had been nurturing since 1917. That's where all this money came from.

Murray and his wife would probably say he closed the firm down because it needed a little capital. "We have millions at home." He can walk across the street and on his signature get a couple of million dollars.

Mrs. Anna McDonnell can say "I have a couple of million dollars in my safe deposit box. I would gladly put some of it into the firm if my son asked me."

Margaret Mary would say "If Murray asked me for a favor, I would do it because I trust my family."

James, the prudent trustee, would be claiming for these same debentures and that same preferred stock, and he would probably tell us he would gladly put a million dollars in this firm as he let Mr. Bishop to believe, but if he would not, there are all those friends of his, Max Fisher, Roy Chapin, Sanford Kaplan and even Henry Ford would have been said to be willing to

contribute to the firm.

Mr. Beebe kept asking the stock exchange witnesses: "Well, you got these reports from McDonnell. You knew all this information about them. It was filed withyou as a regulator. Did you tell the public about these things?"

Of course the answer was no. No responsible regulator tells the public about the information that he regulator learns in the course of his regulation.

Would you want the internal revenue service blabbing about the reports you make to them or to any other regulatory agency? That's not the way responsible regulators work and it's not the way they're required to work.

While we are on this "responsibility to disclose," you heard a lot about these things called knowledgeability letters. I want you to know that there is no rule of the stock exchange that required a knowledgeability letter. The exchange had a practice to protect itself generated back in the days of Ira Haupt when one firm failed as a result of fraud and the stock exchange was sued by people who lost their money. Ever since then the stock exchange said "When we judge that a firm is a little shakey we get a letter from

anyone that wants to make any investments in that firm that says 'We are going ahead on our own and we'll not sue the stock exchange'".

The stock exchange made the judgment that it ought to get such a letter from McDonnell & Company on May 21, 1969. That's Exhibit 56A. You take a look at that letter. You will seewhat I mean by describing it as just an agreement not to sue.

Before you spend a lot of time thinking about this knowledgeability letter, let's see if it would have done any good. Here we have Anna McDonnell who was not a new contributor and was not renewing her contribution. She was just putting some money in a regular old subordinated account. Under the terms of that May 21 letter she was not one of those who would have been required to give a knowledgeability letter even if it would have mattered anything to her.

And Mrs. Murphy, Mrs. Murphy has told us all she did was sign all those documents at 6 o'clock in the morning when the chauffeur came, where somebody put an X. She didn't read anything. So why bother thinking about a knowledgeability letter? Mrs. Murphy would not have paid any more attention to it than she did to anything else.

Then there is James. I think it's pretty clear James knew all there was to know about this firm. He was meeting with his brother Morgan in February -- and all this other information that he put in his claim to the liquidator -- but he did not bother to tell you what was wrong with it. James knew the score.

No claimant has testified to you that if they had gotten a knowledgeability letter it would have made any difference at all. They have not said that. They know that this knowledgeability letter has been around this case for two weeks.

Mrs. Murphy took the stand yesterday. Was there any word as to what would have happened about a knowledgeability letter? No, sir.

MR. BEEBE: May I object to that?

THE COURT: Yes. I think reference to that is inappropriate. Please restrict yourself.

MR. BROOKS: The plaintiffs are not going to argue that the exchange should have shut this firm down in January of 1969 before they came along and put their money in. What are they left with? Well, they have to argue that after they put their money in the stock exchange should have done something different: They should have made a choice here that was different

and that that would have improved the lot of these plaintiffs in some way or another.

There is no evidence of what the plaintiffs would have the stock exchange do differently. There is no evidence that if there were evidence of something to be done differently that it would have helped them in any way, and there is no evidence as to why that alternative should have been the thing that a reasonably good faith regulator should have chosen to do. It's pure speculation, ladies and gentlemen.

Once the plaintiffs become part of the capital structure of McDonnell & Company, unless they decide to exercise that right to terminate in 100 days that Mr. Stein testified about this morning, they are beneficiaries of any favoritism which they claim the stock exchange gave to McDonnell, because, as I understand the plaintiffs' claim, they're saying the stock exchange laid a light hand on McDonnell, didn't regulate as vigorously as it should have, or as it did to other firms, and why didn't it do it?

They say: To let McDonnell make any better go of it, to give them a little bigger chance than anyone else.

Once they put their money in their part of the

firm. If this firm gets a better opportunity to make a go of it, that's to their benefit. So whatever they're saying about the stock exchange after they put their money in it, taking it easy on McDonnell & Company, I say to you that could only help these plaintiffs and not hurt them, and if that's the case they have no business claiming against the stock exchange for any loss in their investment.

Mrs. Murphy puts her money in on February 4. After that I think the record clearly shows that what is going on in McDonnell & Company, particularly in its capital area is a yo-yoing. They thought they had the problem pretty well solved in February. Then along came the discovery that this Flannigan trust really didn't have the right words in its document and that money was rejected. Thereafter Murray came in with more money, 600,000, a million, 650. Mr. McElroy makes his report in April. He takes a look at those January 30 figures and he says "Gee, things were a little bit worse than we thought."

Now, Murray's money comes in after that, and that helps to cure that problem.

What are we doing with record keeping? Mr. McElroy and Mr. Schuette discovery that the record keeping

needs some more work too. Mr. Schuette said "Maybe we ought to put some restrictions on it."

Mr. Fred Stock, whom I think Mr. Bishop described as one of hte really efficient thinkers and experienced people in the line of data processing and working out plans to assist brokerage firms overcome these problems, said "Well, let's get a work plan from them. Let's see what they can come up with to try to correct these problems before we go slapping restrictions on them because, you know, restrictions can hurt a firm as well as they can help it."

They went along for about a month and they got a good work plan, one that essentially had worked for other firms, but on May 21 the stock exchange decided that things needed some more improvement. Mr. McKay, at this time, was taken very ill and died shortly later: He was the back office man.

So on May 21 these restrictions were imposed and a knowledgeability letter required.

Up until Memorial Day of that year, '69, this firm had always exhibited a prompt ability and desire to get in whatever capital was needed. On that Memorial Day weekend when James McDonnell played poker with Mr. Bishop and went back to Detroit leaving an

empty pot, the stock exchange realized there were going to have to be other kinds of capital improvements at McDonnell & Company.

After discussion with the firm, which you have seen in a June 25 memorandum by Mr. Newman, it was decided that the firm would sell off some branch offices, and liquidate some proprietary positions, to improve its capital because capital can be improved in lots of ways: You can get new money and keep your same operation or you can cut your operation back, sell an asset or two, and get some money and remove the capital charge. That's what they did. They brought in some new personnel, Harry Lindh and Paul McDonald. I think Paul McDonald was an impressive man to anybody. He was impressive to the stock exchange and they thought that here was a man with the managerial ability to turn this firm around if anybody could.

Paul McDonnell utilized what we call the black Friday plan. That was a plan that had already been there, he said, in part and it was available at any well run business. It was a way to shore up the situation, to tide you over the tough times.

Going into that August of 1969 we heard a lot about a press release. McDonnell put out a press

release that said: It had concluded arrangements for three to ten million dollars of new capital.

I'm not sure why the plaintiffs bored you with this press release. Neither Anna McDonnell or Margaret Murphy has ever testified that they read it. James said he read it; he didn't believe it. He was wrong. Paul McDonald told us that. He told us they had a deal worked out with Dan Lufkin and a group of investors for about $6 million but it fell apart a couple of weeks later. He told you also that they had made up that $6 million by internally improving the capital situation and that's why no further press release was put out. I don't see what connection it has with this case in any event.

The exchange has no rule requiring approval of press releases or even submission of them. It's entitled to rely on the firm to abide by the disclosure rules, especially a firm counseled by Tom Ford and run by Paul McDonald.

As late as August 20th the firm was telling Mr. Newman that this money was coming in shortly and that family difficulties were holding it up. There is, ladies and gentlemen, I think another red herring.

Throughout the fall the firm was engaged in

cutting back, selling branch offices. It's cutting its personnel and retrenching to its profitable business of rights and New York operations.

Lybrand starts another audit in December of that year and they needed another extension but this year, when they send in this letter asking for the extension, they can't give the assurance they gave in prior December. They say in their February 2 letter of 1970, UUU, "We can't tell you the firm is in capital compliance now. We can't tell you it was in capital compliance when we started our audit."

What to do? Mr. Bishop sets up a committee for a cost accountant and coordinator to come up with some alternatives for McDonnell & Company. They come up with a couple of alternatives which are in an exhibit which has been put in evidence, Exhibit VVV, the bottom line though insists "Unless they can tell us something that is really positive, we think this firm is going to have to close its doors."

slh 1

Now, from February 2nd when the exchange learned that Lybrand couldn't certify until March 13th when the firm went into liquidation, Mr. Bishop has told you that the firm continued in business while the exchange was not certain that the firm was in capital compliance.

You recall Paul McDonald testified about these six weeks, that he was busy getting out as many customers accounts as he could and freeing up customer securities that were pledged on the bank loan, so that when the day came and the doors were closed on McDonnell on March 13th, there would be as few customers as possible that would be prejudiced by the closing of the firm.

Mr. Bishop told you that this was the first and only time the rules of the exchange were not applied normally and across the board with McDonnell & Company as they were with any other firm.

Now, if you will take a look at the capital ratios that are in evidence for McDonnell & Co. in 1969, you will find a good number that are below capital minimum, below the maximum, below 2,000; you will find a good number that are above. That's what that yoyoing was that I am telling you about. The exchange would get one problem corrected; McDonnell would bring in some more money, sell off some branch offices, and next month on the reporting date

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they would have a new problem, and they would take action to get that problem corrected.

Maybe one reported date should go by and things look all right, and Paul McDonald told you that some weeks when the securities business was going good the firm had a lot of hope, and then the volume would take a dive and the securities markets take a dive and things wouldn't look so good.

But February 20th there was a ratio of 1500; March 3rd, 1617; March 24th, 1507 -- and these are as of dates, ladies and gentlemen; you realize these are not reported until maybe a month or so later.

April 14th, 1987; August 27th, 1770; October 29th, 1550; 1630. On October 31st, January, November 7th, 1659.

That is not to say that my friend here, Mr. Beebe, can't reel off to you a bunch of numbers above 2,000. I don't dispute that. What I say to you is that when this yoyoing effect when on the exchange wasn't sitting around on its hands. Every time they came up with a problem there would be a reasonable response taken and an insurance of improvement and compliance.

Now, when the exchange really had a chance to sort out the facts in its chart memorandum, and it had a chance to scrutinize these problems and really decide

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what it could make stick on capital violations, it charged the violations.

Charge 1, as of October 31st; another as of January 30, 1969; four in June; three in July, one in September, one in November, one in December.

That was all the stock exchange felt it could make stick.

Now, throughout this two-year saga of McDonnell & Company I submit to you, ladies and gentlemen, that there is not one piece of evidence to show these men at the exchange had not proceeded reasonably with a plan which was rationally adopted, which has been approved in the business of this trade and of not proceeding in good faith.

I think that is confirmed by Exhibit 86, which is that report to the membership that Mr. Beebe has focused on from time to time throughout the proceedings.

This report shows what was going on in the industry and how plans like this plan the exchange applied to McDonnell worked with other firms across a broad spectrum.

Since it is in evidence I would just like to read to you some of the things it says about what the exchange was doing and in part doing with McDonnell.

It says that these three years, that is, 1967

to 1970, have been a time of perpetual crisis in the securities business. The paper crunch of 1968 and 1969, and the severe profit squeeze that followed required the exchange to intervene actively at one time or another in the affairs of 196 member firms - more than half of all the firms doing business for the public. These firms carried more than 2.2 million dollars in customer accounts, and, significantly, of these 196 firms only about 6 per cent, that is, 12 out of 196 had to be suspended or liquidated by the exchange. That's a score of 94 per cent. In my school days that was an A.

"Today no firm is under restriction." This is today, October, 1970.

"As the paper work crunch eased, one of the severest financial squeezes in the industry's history began. The squeeze was caused by a decline in trading volume and sharply dropping prices which created severe operating losses and eroded the capital of member firms."

Now, I think this shows McDonnell & Company was no exception; that what we had here was an industrywide problem, and the program that was being applied by the exchange to McDonnell & Company was a program that it applied more or less to 194 other firms, and out of that program came up with a 94 per cent grade.

Now, I think that's a sound basis to say what was being done here was reasonable and in good faith.

Now, after it was over the exchange did bring these disciplinary proceedings that Mr. Beebe urges that it should have brought. We have seen that in the charge memorandum, Exhibit 83. It was a charge brought against T. Murray McDonnell and the firm of McDonnell & Company.

What could you do with McDonnell & Company? It was already dead. It was out of business.

The exchange proceeded against T. Murray McDonnell. Mr. Bishop wanted to discipline Mr. McDonnell by suspending him for life from being a supervisory person in any member firm. That wasn't so bad because the SEC had done the same thing to Mr. McDonnell in about April of that year; but what Mr. McDonnell couldn't take was what Mr. Bishop wanted to do in respect to Mr. McDonnell's ability to earn a living as a registered representative, as a producer.

Mr. McDonnell had been one of the leading producers on the street, as Mr. Bishop told us. It was his judgment that some suspension of Mr. McDonnell in that capacity was merited.

To fight off that claim, Murray McDonnell sent a letter to Mr. Bishop dated November 19, 1971, which was a response to the certain charges and to Mr. Bishop's proposal

that Murray consent to this suspension.

Murray says in that letter:

"This reply is submitted in response to your memorandum of charges forwarded to me by letter dated October 26, 1970. I must deny all your statements of alleged fact contained in the charges because they are lacking in validity ***

"I consent to a permanent barring from any managerial or supervisory position with any broker-dealer. I negotiated in good faith after a full investigation by the SEC and agree to this settlement under which the Commission permitted me to at least earn a living for myself, wife and nine children as a stockbroker. To consent to any suspension, in addition, appears to me as unduly harsh and inequitable in view of all the circumstances.

"I took every reasonable action for a chief executive officer in order to provide the company with prudent operating management, from the hiring of McKinsey & Co., Inc. in 1968, and Lawrence O'Brien as president in 1969 down to the ultimate hiring of H.C.B. Lindh and Paul McDonald to protect public interests.

To the extent that the company alleged operated in technical violation of some regulations, there is clear reason why we continue to operate despite the violations.

The Department of Member Firms of the exchange repeatedly urged the company to continue despite the alleged violations because the alternatives of suspension were inconceivable at that time. The violations now recited were known to the exchange while they were occurring and oral waivers were given by the Department of Member Firms to continue while making best management efforts to correct the problems.

Such efforts were vigorously made with the encouragement and collaboration of the exchange. Again, your statement of facts documents the history of waiver and ratification to which I refer.

Thus a question is raised as to the authority of the exchange officials to interpret and to enforce exchange regulations. The position now taken by the Department of Member Firms argues that we should have ignored their oral directives and suggestions, and that they were not personally authorized and responsible in so directing us. Repeatedly the management of McDonnell was advised by officers and employees of the exchange that the regulations were subject to various interpretations under some of which we could be considered not in violation. We were further advised by the same persons of the arithmetical calculations regarding compliance could be arrived at in different ways under some of which we would not be found in violation.

We were assured by innuendo, by oral statements, and by policy decisions that the regulations and the arithmetic would be so construed as to find McDonnell not in violation of these regulations while we made every effort to save the firm.

For over 60 years it was the purpose of the firm to maintain the highest standards of ethics and integrity in the conduct of its business. My own charitable activities included chairmanships of the Committee on Education for the Archdiocese and the Executive Committee of St. Vincent's Hospital. I am a trustee of St. Vincent's Hospital and Brandeis University as well as being a member of the Cardinal's Committee of the Laiety and first vice president of Capital Youth Organization.

The crisis of the last three years in the securities industry is well known. In late 1967 and in 1968, the most active securities markets in history overwhelmed the industry's paper work processing capacity. As the exchange itself has stated, the cascade of paper work into brokerage offices, banks and transfer agents was unprecedented. Unfortunately the magnitude of this crisis has overwhelmed many firms with McDonnell one of the first to go. The exchange itself allowed McDonnell to continue in business despite its critical paper work and capital problems."

Does it sound familiar? Right out of Mr. Haack's letter; it came out a month earlier.

"To exact a suspension of me and deprive me of a living, at this time, would cause me severe personal hardship.

In view of all the foregoing I submit that a disposition of this proceeding along the lines of the SEC order of settlement would be fair and equitable and allow me to continue to earn a living under the close supervision of my current employer."

Ladies and gentlemen, it is a plea of a desperate man faced with the loss of his livelihood.

The exchange didn't buy it. Mr. McDonnell consented to that suspension that he was trying to avoid.

And why did he do it? Because there is absolutely no evidence in the record of McDonnell & Company or the exchange which shows that there was any non-normal application of the rules, any of these oral waivers or innuendos that Mr. McDonnell talks about, and he knew he couldn't prove it, and he signed up, and the stock exchange called his bluff. Only from February 2nd to March 13th when Paul McDonnell was working as hard as he could to get out those customer accounts this firm continued business without normal corrected action being insisted upon by the stock exchange, and now the

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plaintiffs have taken a page out of Murray's book.

Where do you think the idea for this lawsuit came from?

Now you recall Mr. Beebe's jousting with Mr. Arning about the trust fund?

I suppose what they would want to do is pull it all together and say, "The exchange had a trust fund and that's the reason why they didn't enforce the rules in respect to McDonnell & Company."

I don't see how it follows, ladies and gentlemen.

We know the exchange did have a trust fund, and it did elect to assist those customers of McDonnell & Company that Paul McDonald couldn't get out, and it did make seven to nine million dollars available to help them. But what is there to the claim that that is why the exchange did or did not do what the plaintiffs say it did or didn't do?

Well, first of all the trust fund is only usable at the discretion of the exchange or the trustees. The trustees have to decide they want to help somebody, and if they don't want to help somebody and they feel a little financially strapped, they can keep their trust fund moneys; they don't have to help a soul.

You take a look at Exhibit III, the first paragraph, that's exactly what it says. And in the fifth paragraph it says:

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"No one has any vested right, no one has any claim to that trust fund until those trustees decide to help."

So there is no commitment to help anybody. The exchange had no motive whatsoever to apply those rules to McDonnell & Company any differently than it did to other firms, and there is no evidence in this record that it did until February 2nd when Lybrand said it can't certify. Then the exchange said "You have got to get the customers out. Let's try to do it as quickly as we can."

Now let's think about it for a minute. If the exchange had a concern about the trust fund why did it kick back that million and a half in Flanagan Trust money? Why not the Flanagan Trust rather than our trust?

It is clear the exchange was calling them as they saw them. It wasn't looking over its shoulder at anybody.

And think about it a little further, ladies and gentlemen: Have you ever heard of any other industry putting together moneys to assist the customers of a competing firm when it goes out of business? Did you ever hear of that anywhere?

I am not saying this is a completely charitable trust; what I am saying is that in the brokerage industry because of the New York Stock Exchange we have an industry of

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integrity and we have one of financial integrity and trustworthiness, and that's so because of the charitable trust and because the trustees elected to exercise their discretion.

Now I come to the technical argument in this case that I think it's almost a foregone conclusion that the plaintiffs cannot meet their burden upon it, and that's the argument - proximate cause.

That's a strange firm, and it took me a long time to learn it and I am not sure I learned it yet; but his Honor has, and he will give you instructions of what proximate cause means in law.

Let's try to put it in practical terms. Let's say you take your car to a garage and you tell the mechanic you want to fix the wheel.

You get the car back from the mechanic and you go off driving and you come to an intersection, and you see a truck, and you go to blow your horn to get the truck out of the way, and the horn doesn't work, and you hit the truck. You can't go back and sue the mechanic because he only worked on the wheel, and his work on the wheel was not the proximate cause of your damage. Your horn was.

And I say that in this case the plaintiffs, even if they could show that the exchange acted unreasonably and not in good faith, what it did or didn't do to McDonnell

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& Company cannot show you that what was done or not done made their lot any worse, caused them to lose any more money they can show you that the exchange should have closed down McDonnell & Co. before they came along, and you know that we can't do that.

Mrs.McDonnell deposited her money on January 30th, Margaret on February 4th, and James in early April.

Now, there is no evidence whatsoever that the exchange should have been doing anything differently in that period, or if it should have been, how that different course of conduct would have helped these plaintiffs.

Now once they are in, as I told you before, they become part of McDonnell & Company. For better or worse they are riding in the airplane, and if we are going to bend the rules to help the airplane make it to a safe airport, they are going to make it with that airplane.

So their claim has a conflict in it. The conflict is that we made it easier for McDonnell & Company, but after they put their money in they were part of McDonnell Company, so how have we hurt them even if what they say about our regulatory program was not true?

Now, they knew the problems at McDonnell & Company at one time or another. We know that. Margaret knew it when Sandra McDonnell talked to her in the early spring

of 1969. They all got their financial statements, we know that, because the exchange got a letter from Tom McKay dated March 3rd saying that the financial statements went out with the February account statements to all its customers.

There was that meeting at the Carlton House in July that Paul McDonald testified about, and he told you he gave them a straight dosage.

Now, throughout all this time nobody is looking around for a parachute in the airplane. Nobody is looking around to start their hundred days running on their subordinated accounts agreement under which they could have terminated the agreements and gotten out.

Now, there is language in those account agreements which says you can't take your securities out if the firm would be in capital violation; but that's a different paragraph than the one which says you can terminate the whole agreement, and when you wait your hundred days, out you go.

Parachute. No attempt to get out.

Do you remember James' testimony and Paul McDonald's testimony in August, 1969, when they thought about closing the firm down and they called in the lawyers who worked on the Ira Haupt case? What did those lawyers say? "Don't close this firm down or you capital contributors will lose your shirt. The only course is to keep it going."

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That's what they are claiming the exchange did. They claim the exchange permitted McDonnell to keep going.

Now, how could that cause any injury to these capital contributors once they are in if those Ira Haupt lawyers told them that that was their only hope. It was their only hope in August; it was their only hope, as long as they put their money in, unless they elected to use the parachute, and they didn't. They stayed where they were.

THE COURT: Mr. Brooks, are you close to finishing?

MR. BROOKS: Yes, I am.

Now, I think, simply put, if they lost their money it was their own fault because they could have gotten out if they wanted to. But, of course, they were McDonnells, and they weren't going to bail out of the plane and risk the crash of the other McDonnells. They decided to stick with it and ride it out. And why not? All of the money had come from McDonnell & Company, and there was no reason to believe that it couldn't be regenerated and turned back into a healthy firm when the market turned again. As Paul McDonald said occasionally it did during that fall.

Now, unfortunately the gamble didn't work. That's the way it is on Wall Street. Most of us have lost some money on some investment, but that's our loss because it was our choice, just as it was the plaintiffs' choice.

The case against the exchange is simply an attempt to stick the exchange with the plaintiffs' deal. It is not a claim that is entitled to any respect by you because everyone here pays their own way. You do and I do, in good times and in bad times, because it's only fair.

Thank you.

THE COURT: Ladies and gentlemen, we will take a ten-minute recess, and I am going to hold it to ten minutes.

(Recess.)

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(Jury in box)

THE COURT: You may proceed, Mr. Beebe.

MR. BEEBE: Ladies and gentlemen of the jury, as you know, there have been a lot of facts that have come in, but when you analyze those facts, really, this is not a very complicated case at all. It is about what we heard in the beginning, in the opening, the case is about failure to regulate, failure to disclose -- that is, failure to tell the truth.

None of the plaintiffs, as you will see, or as you perhaps have seen from the evidence before you, were given an opportunity to make an informed decision.

You have heard a lot of discussion about a lot of matters, and it's up to you to decide which ones are more important and less important.

You heard the company described by Mr. Brooks in words that made it sound like it was a very solid, a successful company. You would never believe, if you heard that, that it was just a few months later that the company was out of business. It didn't sound like the same company involved here at all.

You also heard some argument about how people would have made investments even if they had been told all thse things. Well, perhaps you can conclude

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that if people, other people, had not heard the same things, other potential investors like yourself or anybody else who might be a potential investor back in '68, the beginning of '69, they too would have made these investments, would have done just what our clients did. If anyone didn't have that information, perhaps anyone would have acted the same way.

I'll go into this in a little more detail later, but I think it's something you should consider when deciding what it is that motivates people to act, to make investments and not to make them.

We have had 19 witnesses including the two that were read in from their depositions and approximately 150 exhibits.

The question really, as it comes down, is not whether or not McDonnell & Company was in serious, in fact, terminal condition -- I think you can conclude it was -- but the question is, when did the problem start? Why wasn't someting done earlier?

You have just heard some argument about an airport, a plane being safely escorted to the airport. Well, if you want to follow that through, the plane crashed, I'm sorry to say.

You also heard questions of parachutes and

perhaps people -- the argument goes -- should have put on parachutes and jump off before the crash. What you are not told is that the parachutes they supposedly had available to them, this 100 days' notice buried in the subordinated agreements, had holes in it.

I'll explain this a little more later and you, of course, can produce the subordination agreements yourself and reach your own determination, but it comes down to this simple: If you exercise a 100-day provision and you try to withdraw your funds, you can't do it if it puts you under the 1500 or 2000 per cent limit. If you exercise the other provision which allows you to terminate the agreement, then the company can liquidate and go into its own liquidation, which you may conclude it had to do at that point because it had not enough money to continue.

There was no choice. When you heard testimony that there was no choice, you can conclude that was because they were locked in the minute they signed. There was no way they could get out. They could not use a parachute when they signed the subordination agreements.

You heard an analogy to a mechanic who prepares the wheel of the car and then the fellow goes down the street and doesn't beep the horn and gets in an

accident. You might consider that's not particularly apt to this situation where the mechanic had the whole car under his jurisdiction and repaired every bit of it, beeping horns and what have you, and the question is, to get back to the reality of the case, did he repair it? Did the New York Stock Exchange repair it or didn't it. If they didn't, why didn't they? And if they did, when should they have done so and what was the result to our clients of their not having done that?

The exchange claims they should get an A for effort for what happened here. I suppose by reading from the Haack memorandum afterwards explaining what happened, the A for effort is that the whole industry -- and I think you can conclude this from the memo itself -- was somehow bailed out and saved.

You can also conclude this happened by the non-application of the rules in certain specific cases and the name case that involves this jury is McDonnell & Company. One was used to save the other.

Mr. Brooks also conceded that perhaps the exchange failed in maybe 6 per cent of the cases. I think you can find that McDonnell was one of those.

Failure was in not enforcing the rules. I submit that's a concession on Mr. Brooks' behalf, and

in the memo itself that's in evidence in front of you as to what it is that the plaintiffs are contending.

There was some mention that knowledgeability letters were required. Things were a little shaky. You may ask yourself: Weren't they shaky in January? You can decide that based on the evidence.

There has been also some argument here, that Mrs. Murphy signed up, and this was stated rather firmly, on February 4. I believe if you look at the evidence you will find -- and search your recollection for that testimony -- that Mrs. Murphy testified that she signed up one morning at 6:30 in the morning and that the notarial seal, the person who notarized it and said she came before her, and so on, was not there, and Mrs. Murphy was not in front of Jane Foley, the notary when this took place. So you can infer, I believe, that Mrs. Foley filled that in later, and the actual signature occurred a day or two after the telephone call, from earlier testimony, made prior to January 29.

A string of ratios were read to you just now apparently from the exhibits, McDonnell & Company net capital ratios. Yesterday, you will recall, in the evidence, another string of ratios were read to you. I would like you to compare those.

The figures you heard today, the first, were McDonnell & Company's own 1968 figures, not the exchange's, not the exchange's analysis. It was the analysis that McDonnell & Company gave on its own account in 1968, and even some of those were over the 1500 per cent warning level. There were not any figures from the exchange. There were not any figures from the exchange, at least as I heard the argument just now -- and the evidence is the best evidence so you can look for yourself -- showing the exchange analyzing McDonnell & Company below 2000 per cent after October 31, 1968.

In fact, I'll go into more detail when I rehearse these and bring them before you as exhibits later on, the figures after October 31, 1968 by the exchange's own numbers, were all over 2000 per cent. If there is one below, that's up to you to find in the exhibits, I didn't hear Mr. Brooks arguing one just now.

The charging memo, as you know, in terms of time on McDonnell & Company, it showed all figures above 2000 per cent. You never saw anything in the charging memorandum. Please examine it yourself. It's in evidence. It shows compliance by the McDonnell Company with the net capital rule after October 31, 1968.

Why is this important? You heard testimony that companies were usually put out of business in a matter of hours. These were hard times. There was a lot of pressure on the exchange, so I didn't hold him, Mr. Arning, to a matter of hours and I said "What's the worse you ever heard?

He never heard more than a week. Those strings of violations are the most important rule of the stock exchange and they went on unabated starting on October 31, 1968 right into 1969 and right through 1969. You can look in the exhibits yourselves.

That's not a matter of hours. That's not a matter of a week. And it all raises the same question, the same nagging question, which we will get to in a little while -- and the answer that these exhibits and this testimony reveals -- why didn't the stock exchange enforce the rules as to McDonnell & Company?

Mr. Brooks also talked about how irksome it would be to a company to have restrictions imposed saying that if a worker was told he could only work seven hours you would hesitate before you told him that because it will cut down on his wages. What you might do with that kind of worker is give him a warning that for some reason shorter work hours were to his benefit.

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Back in October of '68, if I can jump into McDonnell & Company -- I don't want to stray too far -- you could tell McDonnell & Company when the first warnings came out, which you may remember were September 4, Mr. Waterbury wrote a note saying "Why don't they get more capital?"

Mr. Bishop wrote a note saying"conditions seem to be deteriorating." This was on November 7, as I remember it. That's another exhibit in evidence. At this point, or some point around there, you might ask yourself: Why didn't the stock exchange issue a stern warning to McDonnell & Company? Mr. Brooks mentioned "Pulling up socks," write them a letter saying: "Pull up your socks or else we are going to do something to you."

That's not going to hurt anybody. That's not going to take away his eight-hour work day. McDonnell was not working eight hours a work day; they were working 12, 14, and 20 hours a day. That was not healthy for the company. It was unhealthy, as you may see for yourselves from the exhibit in the evidence. McDonnell was not a healthy company.

At a point like that it's to the company's advantage to tell them to slow down your work, just like

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it would be to a man who is compulsively working 12 and 16 and 20 hours. There were labor laws passed in this country at the turn of the century for the protection of people who were forced to work too hard, and that might have been a good thing here, to have done something to reduce McDonnell's overworked conditions, an overheated plant which was causing it, as you finally heard, as seen through the exhibits, and testimony that the deteriorating operating conditions led directly to the capital problem, so you can't solve one and leave the other to fester because the other one, the capital problem, was going to come back again and again and again, which is exactly what happened.

The Scheinman, Hochstein deal late in 1969 or August of 1969 was given a net capital credit for some reason? Was an exception made there? You heard a lot of testimony that the net capital rule required, whatever it was that you were going to give, an asset value was to be a liquid value. It was not liquidity for public customers, which seemed to be what was argued this afternoon. The net capital rule required liquidity of that asset. It had to be good cash or convertible into good cash in short order. You can look at the exhibits yourself on Scheinman, Hochstein, and you may conclude

from that that this was a letter of intent. This was not a guaranty. The word "guaranty" was used. There was no guaranty in there. It was a letter of intent which never, you may find from the evidence, actually materialized. No money came in. No money was subordinated. That was the alternative that was mentioned just now.

Neither of these alternatives occurred. Why? Why would that be given good capital status by the exchange? Why make an exception?

This was a rights firm. This was a rights firm back into the '20s. It was the only one on the New York Stock Exchange, and you heard some argument, the argument to give credit on the trade date for capital purpose; it was battered back and forth. That's nonsense. They had been an arbitrage firm for years and years and years. Why do you have to change the trade date or the settlement date? There is only one reason. They needed capital. That's why Waterbury wrote the note "Why don't they get more capital?" and Mr. Newman wrote the note. The Waterburys, Newmans, and Spies and Schuettes were all lumped together with Mr. Bishop and perhaps Mr. Arning in the argument here. I put them in two categories.

You saw that the people down at the front lines, at the lower levels, were all saying, "This is not good capital" -- in each of these cases -- "and McDonnell shouldn't get a special exception."

This was according to the honest man on the front line. And something happens upstairs and they get a special exception. That's what happened here.

Are stock record differences something that's going to evaporate in a little while? There is a monetary difference there. It's not very important -- that's what the argument was. It didn't evaporate here. You said stock record differences just build up and up and up, according to the records.

The income tax credit, the testimony from all sides was that you had to demonstrate it was receivable within 30 days. You could walk through Andover, Massachusetts or something like that and lo and behold it was going to be coming in, and you can say this was good capital. It was proof that something was happening. There is no evidence of that.

There is evidence that the income credit appeared and was granted to McDonnell & Company all summer, all the time, and none of these liquidity requirements were met. These were exceptions, exceptions

that were made for this company. Why? Lettered stock. It had to be demonstrated it had a value. Where is the demonstration here? Where is the evidence that shows that this lettered stock had any value at all? Why do they get special treatment?

You also heard some argument that they tried to slip in the words that McDonnell & Company was supposed to protect the stock exchange, was supposed to protect public customers. That was their obligation. You may find from the rules, and his Honor's charge, that there were obligations to support money lenders that were just as strong and as vital and important, certainly in the case of our clients.

On the debenture, some differentiations made between the Manufacturer Hanover Trust and the way it was treated by the exchange, and the way that the trust and the debenture rollover in this case were treated. I submit ladies and gentlemen that that's really splitting hairs. If you look at the trust instruments in either case you would see on the face of them, as far as McDonnell & Company was concerned, that it needed majority authorization. In fact most trusts which had multiple trustees would require the majority of them to act. Even on the face of the exhibit it

does not say two lines for signatures. It does not say "Murray McDonnell signing on behalf of some other trustee"that gave him oral consent. There is no evidence to the contrary. In fact there is no evidence at all that any of the other trustees affirmatively authorized it.

There was an argument at the beginning of Mr. Brooks' summation that, as best as I can make it out, James was some kind of security analyst back in 1940 and therefore he knew in 1969 when he came in that there were a lot of things wrong with McDonnell & Company, all the things that we know now from what the exhibits have shown, and that therefore there was not the things that were wrong that prevented him from going in but it was the fact that he wanted to help the family company.

I got a lot of trouble making that juxtaposition and you may too, because there has also been testimony that he was not particularly close to the family company -- if I can understate it a little bit -- not only in proximity working out in Detroit, but also in love and affection for his brother, which there might have been some distance between. I think you can find that. And as a businessman he was not in the securities business.

I hope you were not confused by that because it appears that back in1940 he worked a few weeks in a bank.

Going back to Mr. Stein's argument -- what I'm saying is not testimony, it's argument. What all the other lawyers say is all argument. The jury, from the facts and the evidence and the testimony, has to make up its own mind.

You heard about Mr. Ford in relation to Anna McDonnell. Mr. Ford testified that his client had done this or done that in 1962. I hope you will remember his testimony that in the 1962 meeting he was representing I don't know how many different interests.

I think at that time various people were relying on him as his clients. One was Mrs. Anna McDonnell, and one was the company, McDonnell & Company. He didn't tell her at that meeting, according to his testimony, that he stopped representing her for the purpose of that meeting and that he was representing the company. He never let that out.

He also told you, I think you should remember, that in the 1962 era the company was not in financial difficulty but that in 1969, January 1969, it definitely was, and that he didn't tell Mrs. McDonnell in 1969, Mrs. Anna McDonnell, anything about these

pgr

difficulties.

He also testified that he destroyed some files relating to McDonnell & Company after this case started. I guess you can draw whatever conclusions you want from that.

There was one argument by Mr. Stein that no one would say that Jim McDonnell was a pigeon. You can surely conclude from the evidence here that Jim McDonnell was not told all the things that were wrong with the company. He got that Exhibit J at one point to which a to-do was made. He never denied he got it. He didn't know when he got it. He was trying to be an honest man on the stand. He certainly didn't get it with the batch of material from Mr. McKay because it wsa not listed with his letter.

He was not told that. There is no testimony from any witness, from Mr. Stein or anyone else, about all this information about net capital violations and bookkeeping problems and two partners withdrawing with $400,000 in January, 1969, lost profits, lost profits of $1,100,000 before taxes in the last four months of 1968.

In fact, the information he got showed a profitable company. And this information was delivered

to himin April by the comapny.

So I would not put from your minds the thought that Mr. James McDonnell was a pigeon in the sense he was not told and his money was pulled into this business.

That Exhibit J, that little print up that they had of what the company's financial status was, it's summarized in there, it didn't say anything about the computer conversion that had been started back on the July 4 weekend -- it was promised to be in operation. It had not worked. It didn't say anything about the ten days of blank records.

Paul McDonald testified to that. 20 to 200 million dollars in 1968, a contingent liability on the books.

Ladies and gentlemen, I submit you can find that's a material omission.

Mr. Stein also mentioned that when he went to law school they started off with a lecture on common sense. Others start off law school, I seem to recall, with a lecture, opening course, on equity, fairness, and justice.

This is still a case just as it was from the beginning to the end about failure to regulate and failure to disclose, that's failure to tell the truth.

pqr

The arguments that the exchange regulated properly sounds as if there were people making them who had been somewhere else for the past three weeks not listening to the testimony here.

In my opening statement I tried to give you a road map of what we were going to prove and how we were going to try to prove it, and since then we have introduced evidence trying to prove the points which I will go into in more detail now.

In summation the function is to take us back over the territory that we traveled together and pull the evidence together and present it to you for the first time from our point of view in one place without interruption.

The first chapter goes back to the first restrictions and it sets the stage for the later events. It's very important. It shows a frame of reference from which to measure the later actions. We start with the delays in receiving the 1967 audit. McDonnell & Company requested and received five extensions. That's shown in Exhibits 68 and 70.

The stock exchange then issued a general warning on March 14, 1968, to all members of the exchange and said, in Exhibit 78, "There is a disturbing minority of member firms whose record keeping is so poor they

need extra time to complete their audits." I'm not going to cite all the exhibits. I'll mention some from time to time.

The exchange also warned in this exhibit that it would impose restrictions for delays and poor record keeping.

This went to all members, not just McDonnell.

Finally the exchange particularly warned, in this memo, thatit was unwise to try computer conversion when record keeping is in poor shape.

That was a good standard, I submit. I submit you may also use that as a measure of what is a reasonable reaponse to the problems of McDonnell & Company had and what the exchange did in responding to them.

On March 18, four days later, the exchange imposes that standard on McDonnell & Company and imposes restrictions because of the record keeping deficiencies. That's Exhibit 79. They did what they said they were going to do. The restrictions told McDonnell & Company, among other things, "Don't transfer registered representatives for the foreseeable future."

It also restricted McDonnell & Company from making "any further commitments of any kind which would

tend to increase your business."

That's like the argument of not letting a guy work too many hours because it's not good for his health. That's what they did back in 1968. We call these, and you may consider them, the "now you see them and now you don't" restrictions because they quickly disappear.

They were good restrictions, and if the exchange had only stuck to its guns and done what it was supposed to do, we submit that the plaintiffs would not be here, and you can find from all the evidence that our clients would not have been separated from their money. The trouble started when the exchange lifted the restrictions 17 days later. That's what the evidence shows. It was the height of the paper crunch in early 1968.

McDonnell & Company promptly, very promptly, launched a computer conversion, opened another branch office, and went back on the unrestrained expansion trail.

If any doubts were raised in your mind by Mr. Bishop's unsupported testimony that he was just putting those April 1968 restrictions on to shock McDonnell & Company, think back to Mr. Schuette. You are

the judges of whether or not a man is telling the truth. You may find Mr. Schuette was more forthright, open, and honest here in this courtroom.

Mr. Schuette testified that he was the coordinator directly in charge of McDonnell & Company from 1968 through April of 1969, which is the key period in question, and he said from his review that "The basis of putting those restrictions on in 1968 was the company's inability to handle its business, and that the problem was more than a customary one" -- and that's a quote from page 817 of the transcript.

Perhaps the best summary of events during this period was prepared by Mr. Schuette. It's dated March 28, 1969, and it's Exhibit 46. It's a kind of checklist chronology. You may wish to review it during the course of your deliberations.

McDonnell & Company first promised, as that exhibit shows, that they would make the total computer conversion over the July 4, 1968 holiday. They failed to do so. They failed again and again, and the situation got worse and worse. I don't think there is much dispute that the computer conversion and the loss of key personnel at McDonnell & Company in 1968 was what led to the operating delinquency. They had gotten serious

enough so they led, from the evidence you can conclude anyhow, to the financial situation and the deteriorating conditions of the company in 1968.

A lot of this case is not whether there was a problem but when there was a proglem. That's what a lot of shooting is about.

Mr. Schuette testified that McDonnell & Company went to voluntary restrictions in July of 1968, but hetestified that on top of voluntary restrictions he was recommending to his superiors late in 1968 that the exchange impose real restrictions,not these voluntary slap-on-the-wrist type things which is even self imposed. There is no muscle in that.

Strangely enough, after listing the April restrictions in 17 days, the exchange kept only a light finger on the patient's pulse and watched the condition deteriorate. It got the information because it received these SOO reports. But the exchange doesn't prescribe medicine. The patient goes out.

This is important because with all the information they have at their command you can raise a question in your mind as to what motivated the exchange not to act. For example, Exhibit 82 was a report from the company to Mr. Bishop showing fails to deliver

totalling $32 million and fails to receive totalling $31 million. Mr. Arning admitted -- that was Mr. Bishop's boss who testified here -- "Those numbers are very large and there is no way to describe them any different."

You may ask yourself if those figures, 31 and $32 million on each side of the fails, were an improvement on July 16, 1968. How bad were things in April? And if they were worse in April why were the restrictions lifted in 17 days?

Arbitrage. This is the last time you are going to have to hear about arbitrage. In August of '68 McDonnell & Company made its first plea for a special interpretation of net capital campaign. This was an arbitrage matter we heard testimony about and saw some exhibits. You can find that the arbitrage matter comes down to this: The exchange examiners and the coordinator, and I guess Mr. Waterbury, who was the assistant chief examiner, all felt that McDonnell & Company should not be treated any differently under the arbitrage than anyone else.

McDonnell & Company by its own admission knew that the position it wanted was not in accordance with Rule 325. That's just another way of saying violation of the rule.

That's just another way of saying a violation of the rule, and that's in Exhibit 60, 71, 72 and LLL.

If arbitrage was a normal exception to the rule why had the exchange examiners never heard of it? Why did they keep insisting for two months the rules should be applied in the normal way?

You may infer that the words "not in accordance," were simply a polite way of saying that they wanted special treatment, which they got, they finally got.

Now, this is more important as far as arbitrage is concerned than just special treatment, because as the examiners recognized, when a fellow needs a special interpretation of that nature it has got to be because his capital is getting pretty close to the limit. That's the problem, and that's exactly the question that the examiners asked.

In Exhibit 96 Mr. Waterbury says -- and this is on September 4th, which is really quite early, 1968, memo to Hank Newman:

"If McDonnell's activities in this area are so large and it is necessary to get special treatment to meet capital requirement, then I think they need more capital in their business."

That's a quote.

You may infer that Mr. Waterbury and others were

correct in their analysis of the current situation and the about face of the higher ups, the stock exchange's higher ups, represented one of a series of breaches of the exchange's regulatory duties.

When McDonnell & Company still had not received special treatment that they wanted by October, they took it upstairs. It was told that the SEC would have to be informed of the special treatment, and McKay, the fellow who was running things over at McDonnell & Company in this respect at that time, says -- is quoted as saying by the exchange-- and this is one of their exhibits, Exhibit 60: "He was not at all happy about having the SEC know of the proposal."

Newman writes: "Why don't they bring in more capital?"

Instead they got an exception, and they got over that hurdle.

Then there comes a turning point, and that's November, 1968. On November 7th Mr. Bishop typed a note to Schuette -- that is Exhibit 35A -- and he says, "I am told that McDonnell & Company has lost several vice presidents, seven to eight of them since the death of Sean McDonnell."

This would belittle the rumor, but I don't hear any testimony or evidence coming in that it wasn't true.

"In addition McKay is in poor health," which also

slh3

proved to be true because he later died in the summer of 1969--"and the man they hired to relieve him has left the firm. Their operations and control is therefore said to be declining rapidly."

It's kind of hard for these things to argue that they didn't know what was going on when Mr. Bishop writes this kind of note, when they have complete access to all the books and records; when they could go in and find out anything they wanted to find out. They could find out what the profits were on a daily basis if they wanted to, certainly on a weekly basis, and find out about all the other problems. They could have found out about the time when the records broke down.

Well, anyhow, Mr. Schuette writes back:

"The attached summaries will show the progress and lack of it since April for McDonnell."

Then he says that the audit would help to find out what was going on, but also that the October MF6 and operations Q due in a few days will further clarify the picture. But nothing happens.

There is no report that comes back to Mr. Bishop saying, here's what it was like before and here is what it is like now.

There is no magic in the audit. There is no

slh4

requirement that you have an audit before you do something. That's not one of the rules. If it were a company could be in trouble all year round and wait for the annual audit, and spruce itself up at the last minute.

Well, on top of that Mr. Schuette testified slightly differently than Mr. Bishop.

Mr. Bishop seemed to read that as a pat on the back for McDonnell & Company. You can read it for your own selves and make your own determination. When he says their operations and control therefore seems to be declining rapidly, I think you might find that that is not exactly a pat on the back.

But Mr. Schuette testified that the operating conditions at McDonnell & Company had deteriorated badly in late 1968.

Now, these reports and the rules are in evidence, and I would specifically direct your attention at this point to Rule 440; that is the official record keeping rule, and it says you have got to keep your records in good shape.

The charging memorandum which the exchange finally wrote was consented to, and it found that Rule 440 was one of the specific rules that was violated.

From that and the other evidence you can readily infer that McDonnell & Company was already in violation of the

slh5

record keeping rules in 1968, and if the exchange had only bothered to dig a little deeper, to do its homework, to do what it should have done, would have acted and responded to the violations that were existing sooner, long before our people were reached out for and their capital was pulled in.

What about these blank tapes? They called Paul McDonald who later tried to save McDonnell & Company, and here is what he found as he went through the books of the company.

He found that "In November, 1968" -- this is a quote -- "there had been a time span of some ten business days when the computer simply exlaxed blank tape; there was nothing but blank tape that came out of this machine."

How much was involved in monetary terms or book-keeping terms, if you will, in this November, 1968, record keeping snafu?

Mr. McDonald testified there was a contingent liability somewhere between 20 million and 200 million dollars. That is November, 1968.

You may conclude within the confines of the securitie laws as his Honor charges you that that was an extremely important fact.

You may also conclude within the regulatory laws

slh6

that that is an extremely material fact as far as the person who is charged with regulating the company is concerned. That is, just to keep our eye on the major culprit here, the New York Stock Exchange.

Mr. Arning admitted that every computer conversion at McDonnell & Company was disastrous.

In May -- if I can jump ahead for a minute -- in 1969 when the money finally did run out, people wised up, if you will; the exchange imposed restrictions on McDonnell & Company.

Why didn't they do it earlier? Why didn't they do it when the problems were still possibly solvable?

You could find from the evidence that the exchange bought time; it bought time for itself, bought time for the other members of the stock exchange, bought time, and, hopefully, a reduction of the claims against the special trust fund, and that is exactly what happened by using our client's money. They had to keep those conditions a secret in order to keep our clients unsuspecting and bring them in; and the basic motivation, as in so many things in life, unfortunately was in protecting their own pocketbook. It was money. That is what motivated them to act the way they did.

Mr. Bishop admitted in his deposition and finally here on the stand that the problem with McDonnell's

supervision, another rule that the exchange is required to enforce, started with the death of Sean McDonnell in July, 1968. And the charging memo specifically found that one of the violations was Rule 342 pertaining to the supervision and control.

Now, we have reached the first transaction which is the debenture roll over. That is the substitution of Series E debenture for the B debenture, December 31, 1968.

As his Honor will tell you in his charge, a debenture is a security for the purpose of the antifraud statutes under the federal securities laws.

The debenture, Exhibit 19A, you may find that it was due and payable by McDonnell & Company to a trust created under the will of the senior Mr. McDonnell, and the evidence shows that it was in the amount of $318,622.97.

The evidence also shows that it wasn't paid on that date.

Instead they substituted a new piece of paper called a Series E debenture which was not payable until 1978, and you can find from all the evidence that that piece of paper is worthless.

Two trustees were required to approve this kind of trust transaction, but only one of the trustees did.

Exhibit 19C doesn't even contain a line for a

slh8

second signature. It doesn't even pretend to be signed by the correct number of authorized trustees.

One trustee, Murray McDonnell, had a clear conflict of interest. His signature should not have counted for anything.

Speaking of conflicts of interest, we are reminded that Mr. Ford testified also concerning his representing different people at different times.

Murray McDonnell at that time was heading the company, McDonnell & Company, and the exchange knew that it had a lot of problems.

No one, it appears, did what a reasonable, cautious person might do at that point, look at the trust instrument and see if the procedures, or just a bare minimum of the procedures were carried out.

So you may find that the roll over of the debenture in that manner was an act, practice or course of business which operated as a fraud on the trust.

It is undisputed that the exchange obtained and checked trust instruments, but not in this case.

The exchange appears to argue that they could rely on Lybrand, these outside auditors, to check the roll over and check the underlying instruments to see that fraud was not committed, and, obviously, Lybrand didn't do it.

s1h9

If the exchange misplaced its reliance on Lybrand, that's between the two of them.

The exchange can't shirk i responsibility to investors by trying to blame someone else. You see quite a lot of that in this case.

The exchange has what is called primary responsibility for its acts.

In layman's terms, as Harry Truman said -- and I am quoting him again -- the buck stops here. In this case it stops at the New York Stock Exchange.

The exchange's argument that it somehow is not responsible for the roll over transaction shows how differently the exchange acts depending on who is involved.

You recall from the testimony of Mr. Bishop and the exhibits in 1969, three months later when the Manufacturers Hanover Trust Company was the trustee, the exchange protected them thoroughly. They reviewed the trust documents. Where is the consistency? Where is the even-handed treatment?

Ask yourselves that question and you may find that wasn't here where our clients were involved.

How can the exchange close its eyes to an unauthorize transaction substituting a worthless piece of paper for a $318,000 debenture? How can it do that and claim that it has adequately fulfilled its statutory duties as a regulator?

slh10

The answer you may find is that the exchange simply can't make those claims.

Now I think, your Honor--

THE COURT: Are you finished with that subject?

MR. BEEBE: I have reached an appropriate moment.

THE COURT: Have you finished with the subject of the debenture?

MR. BEEBE: Yes.

THE COURT: You are going on to something else?

MR. BEEBE: Yes.

THE COURT: Ladies and gentlemen, we will stand in recess until 10 o'clock tomorrow morning.

(Adjourned to May 21, 1975, at 10 A.M.)

MARGARET MARY McDONNELL MURPHY, et al.
vs.
McDONNELL & CO., INC., et al.

May 21, 1975,
10 A.M.

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(In the robing room.)

MR. BROOKS: Here are some more requests to charge.

MR. BEEBE: I haven't got copies.

THE COURT: You haven't?

MR. BROOKS: We haven't exchanged requests to charge.

MR. BEEBE: I am willing to exchange anything.

THE COURT: I think you should.

You have not done it?

MR. BEEBE: I have been willing to.

THE COURT: I think you should. I think you should on the charges. On the other hand, if you haven't done it --

MR. BEEBE: I have been willing to.

MR. BROOKS: My point in meeting, your Honor, was to protest some of the points Mr. Beebe argued to the jury yesterday as not being supported by the evidence and as being contradicted by the evidence, and those were

important enough for me to ask for a meeting.

I didn't object at the time because to make the point would have required me to scuffle around in some other transcripts and would have interrupted counsel's argument.

I am aware that counsel have great leeway in making a summation and to ask the jury to make any inference that is possible to be drawn from the evidence.

MR. BEEBE: I stand ready to back up with citations everything, and it had better be good, because I want to get back to it.

THE COURT: All right, Mr. Beebe, let's not defend before you know what it is.

MR. BROOKS: The biggest problem I had was Mr. Beebe's argument that Paul McDonald testified that the computer elaxed ten days' worth of blank in November, and that there was therefore a contingent liability of $20,000,000 that was generated in November.

THE COURT: Yes, I noticed that myself.

MR. BROOKS: That, I suggest, is contrary to the evidence.

MR. McDonald did testify about a blank of ten days in November on the New York computer system. On his redirect he said yes, they were running a parallel system.

Mr. Bishop testified that the firm had always been running a parallel system, and that their official records were on the NCR system, and the firm's January 28th letter to the exchange, which was Exhibit B-1, says that we are running parallel tests on the old system and the IBM 360, but we have never had put any live output on the IBM 360.

THE COURT: I remember at the time, Mr. Beebe, the argument as it struck me going to the jury was that the ten-day blank was something that the stock exchange should have known about in January of 1969 when, in fact, McDonald didn't go with the company until the summer and didn't make a determination of this contingent liability until some time, obviously, after he was engaged.

MR. BEEBE: Maybe I answer that from the promised citation?

THE COURT: Yes.

MR. BEEBE: As Mr. McDonald testified at page 1806, there was a ten-day blank which we all remember. I think I said "exlaxed," and he said "elaxed."

THE COURT: Yes. You were more graphic than he.

MR. BEEBE: I was wrong. He was right. He had a better word.

THE COURT: That's his word.

MR. BEEBE: Apparently there is such a word in computer jargon, and I guess we have got a big computer trial going on down on the first floor, and maybe I should go down and talk to Ray Carlson or Tom Barr to find out what the correct word is.

In any case, he said: "There was nothing but blank tape that came out of this machine."

And then he testified -- and this is not included in the little summary we heard this morning -- that this created a contingent liability of somewhere between twenty million and two hundred million.

Now, as I heard what he said --

MR. BROOKS: I have the record here. Would you like to look at it?

MR. BEEBE: [illegible] I heard what he was saying, he discovered this the next summer when he came on board and looked through the records and said, "What is the situation?" And looked at the Black Friday plans, and this was one of the situations they were faced with and never solved it.

Now, your point, your Honor, is, if I said that this information was transmitted from McDonnell to the exchange prior to January? I didn't say that.

THE COURT: No, I know, but as I remember the

argument, from the flow of the argument the jury could well have concluded that this was something the exchange should have known about in January, 1969.

MR. BEEBE: Well, I submit on that score, your Honor, that is a fair thing to argue for this reason.

As Mr. Bishop himself testified, and as is well known, the exchange could go in and do as close scrutiny as it wanted to do, and on something as important and material as that surely Mr. Carley and the other fellows on the scene should have discovered this. They should have discovered this. But I didn't say and I am not arguing that they did discover it.

MR. BROOKS: Your Honor, there is nothing to connect up a $20,000,000 contingent liability with November at all, not Paul McDonald's testimony or anyone else.

How can anyone suggest that when the auditors were in the middle of the audit that a $20,000,000 contingent liability has arisen in an audit which gives rise to a $16,000,000 net worth? That is a material fact.

THE COURT: Well, let's see what the catalog of problems here is, because we may have to grapple with this in some fashion, I don't know. I may have to give Mr. Brooks a chance to respond. You know, we are doing that now starting this month in criminal cases, and as a

criminal defense lawyer for many, many years, it was dreadful that the prosecution had the last go round without an answer. Now we are at last recognizing that that is no longer to be. In other words, we don't have a situation of an unanswered argument. We may have to grapple with that depending on some of this.

Mr. Beebe, you have a style that is a very florid style in argument, and sometimes some of this can pop out in that fashion. I remember hearing this.

There was also one statement that was made about how the stock exchange should have known something, and then reference was made to the October, 1968, audit, leaving it as if they should have known in October of 1968, and these are matters of argument. But it is, as I say, a matter of concern that in the enthusiasm of a closing argument, particularly with three weeks of testimony, that we don't leave the jury from time to time with some inference that is not genuinely warranted.

I don't say this is done as a deliberate matter; this is just a matter of an advocate's rush forward with the facts.

MR. BEEBE: May I say, your Honor, that I have prepared the argument, but yesterday and today, very, very carefully --

THE COURT: I am sure you have.

MR. BEEBE: -- and I have gotten for my own benefit citations for every major point I am making and every fact that I am arguing.

I would say that if wrong inferences were drawn or argued, they came yesterday at two points in Mr. Brooks' summation.

The first point was when he read that list of ratios --

THE COURT: But you can answer that. That's the thing. You can answer that, and you did come in with an answer to that.

MR. BEEBE: And the second one was when he seemed to say - and I am not sure what he wanted the jury to believe - but I know what I read out of it was that the source of this lawsuit was somehow Murray's letter, or incorporating language from the Haack memo.

I never saw that Haack memo, and no one in this office saw the Haack memo until about a month ago when I found it --

THE COURT: No, Mr. Beebe, all I am saying is that advocates make arguments, and sometimes the arguments go beyond what the record strictly will support.

You have had a chance to answer your two brothers,

and Mr. Brooks is in a position of concern that he doesn't have a chance to answer things that he feels are unsupported.

MR. BEEBE: My answer to that is two important things: One, because of the way this case was argued and had to be apparently presented, I presented most of my arguments at the time of the motion to dismiss.

And also I was put in a position of having to read that Murray McDonnell letter in my summation. Mr. Brooks took all of that preparation that I had spread out and laid on my sleeve and used it to answer ahead of time and steal all my thunder --

THE COURT: Oh, come on, you have the last answer. You have asked me for three hours to answer two hours of argument against you or two hours and a half against you. I am sure that you can take care of yourself. I don't see any prejudice to you on that score.

MR. BEEBE: All right, if I go overboard at any point -- I don't think I am going to -- I wish at that point if there is some correcting to be done, it be done, but not in some surrebuttal type of argument. I would find that as abnormal as I find the New York Stock Exchange enforcement of its rules.

THE COURT: I think in the middle of summations when opposing counsel jumps up and we have a wrangle of

what the record is, that takes ten minutes too, and I am not sure which is preferable.

MR. BROOKS: Your Honor, I have two more points.

MR. BEEBE: If they are specific points maybe I can address myself to them at that point. But up to now I don't think I have done anything --

THE COURT: I am not saying you have, and I don't want anything to be construed that way. Far from it.

All right, can we get the jury in?

MR. BROOKS: I have two more points.

THE COURT: All right, get the jury in anyway.

MR. STEIN: Let me just put one statement on the record.

I want the record to clearly reflect that the receiver joins in the requests for instruction that Mr. Brooks handed up this morning, that is request 35A, by the New York Stock Exchange.

In addition the receiver joins in requests 1, 4, 5, 6,. 7, 8, 9, 10, 11, 12, 13, 14, 15, 36, 39, 40, 42, 43, 44, 45, 46 and 4A of the requests that have been previously marked.

MR. BEEBE: And while we are putting things on the record on charges, we have made a request that a charge be issued concerning the fact that no inference can

be drawn from the fact that a party or a person or a witness was not called---

THE COURT: Yes, I am going to give that in my charge.

MR. BEEBE: -- was equally available to both sides.

MR. BROOKS: My second point, your Honor, is that Mr. Beebe estimates that the jury could conclude that Mrs. Murphy executed or subordinated her account in January of 1969.

I suggest there is no evidence to support that. All of the agreements are dated February 4th. The telephone call --

MR. BEEBE: No, I don't think --

MR. BROOKS: Let me finish.

And Mr. Beebe's pleading in the amended complaint which was drafted a few months before this trial started, not four years ago, a few months before the trial started, says that plaintiff in February of 1969 entered into a subordination agreement with McDonnell & Company.

I say on the basis of the evidence and the pleading Mr. Beebe is precluded from arguing anything in January as to Mrs. Murphy.

MR. BEEBE: It is an as of date.

If there is that problem, your Honor, I would like to amend the pleading to conform with the proof.

MR. BROOKS: The proof does not support anything other than February.

MR. BEEBE: I think your Honor might find differently. She got the call the next morning and signed up the papers, and --

THE COURT: Well, that would be dealing with Mrs. Murphy's testimony in detail. I would not be prepared to say that this is not a fair argument based on the documents and the testimony.

MR. BROOKS: The other thought is Mr. Beebe's remark that the exchange reviewed the roll over documents signed only by Murray McDonnell, looked at it, saw that it was only Murray McDonnell, and didn't treat this trust the same way it treated Manufacturers Hanover Trust.

MR. BEEBE: If I said that I went too far.

Could I have the citation where I said that?

MR. BROOKS: The transcript is not printed yet. I went up to get it.

There is no evidence the exchange saw any of these documents. Mr. McElroy testified that they would rely on the Lybrand audit report.

The review of the Manufacturers Hanover Trust under

the exchange's practice was just to see if the trust instrument authorized the investment, and there is no question in this case that the will of James F. McDonnell, Sr. authorized this debenture to be in McDonnell & Co.

MR. BEEBE: I am going to start, your Honor, to talk about the debenture. I don't think I said that because it has never been my point.

THE COURT: Well, let's see what the transcript shows.

All right?

MR. BEEBE: Oh, 96A. I am going to just get that out of the way when we get outside in the courtroom.

THE COURT: All right.

(End of robing room discussion.)

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(In open court; jury present)

MR. BEEBE: Your Honor, first the minor matter of getting 96A, the retyped version, in evidence.

MR. BROOKS: No objection.

(Plaintiffs' Exhibit 96A was received in evidence)

MR. BEEBE: Ladies and gentlemen, where we left off last night was with the debenture substitution; and I do have a few more words about that; and it's most convenient to talk about it right away.

There was, by the time the debenture substitution took place in December 1968, a good many red flags waving in the air as to what the situation was at McDonnell & Company.

First, there was the request for a special arbitrate agreement which showed that the operations problems were leading to capital problems. This was done in September 1968. The warnings by the exchange personnel that capital was needed at the company began in September 1968 and continued in the fall.

Coordinator Schuette urged that new restrictions be imposed. These warnings reached Mr. Bishop. Mr. Arning knew that McDonnell had problems because he gave them the special arbitrage treatment that they

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wanted.

The continuing failure since July to convert the computer was having direct and serious impact on the operations, and this was visible to the exchange in the reports received from McDonnell & Company. For instance, they were summarized in the attachment to Mr. Schuette's memorandum which is Exhibit 35A. The exchange knew of Sean McDonnell's death and was warned that seven or eight vice presidents had left.

By Mr. Bishop's own memo the exchange had heard that operations and control were "declining rapidly." That's November 1968. How much more notice do you need?

On December 23 Lybrand writes a letter, and that letter is not, you may find, at all helpful to their position that it assured them that things were in good shape. In fact, just the opposite of what Mr. Bishop would have you believe about that letter. After some self-serving language in the Lybrand letter about having no reason to doubt that McDonnell would meet the capital requirements if everything could be counted, Lybrand then warned, and I am quoting -- this is December 23, 1968 -- "If the exchange in conformity with our understanding of its practice" -- that's the

usual rules -- "required full provision for the values of such securities" -- that is if missing securities -- "McDonnell would not have met the exchange's capital requirement as of October 31, 1968." There it is in writing.

This wasn't a rollover as it's been called so often in December 31. This was a new issue. The series E debenture was substantially different, you may find by examining and comparing the two of them, from series B.

Now, when you have a new IOW, if you want to call a debenture that, with different terms, doesn't it make sense to review it from a legal point of view, and decide whetherthe law has changed, whether new statutes have some into being, new legal authorities over the ten years since the first one came in, the series B debenture. To find out whether the new series E debenture was authorized under the trust, substantively authorized under the provisions of the trust agreement. There is no excuse for failing to review, and certainly no excuse for failing to review the procedural due processes to find out whether, whatever the trust instrument said was the required number of trustees, actually authorized it. That certainly should have been

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done.

There were only nine debentures due on December 31, 1968. Contrast that with McDonnell's situation at that time. They had what, 350,000 customers, we have heard them.

Once every ten years? Is this an enormous burden on the exchange to review a trust instrument which was in their files? All they have to do is look atit. All they have to do is find out whether the authorization took place.

Is verification too great a burden when it would cost 20 cents for two phone calls to find out whether the other trustees signed up and authorized before accepting an E debenture of this troubled company, a major capital investment at this point of $318,000. No checking, no checking. All the red flags were up. No checks were made.

Under the law, as his Honor will charge you, to satisfy the requirement of good faith, it is necessary for the exchange to show that it took precautionary measures to prevent fraud. The trust instrument was in their possession.

Another comparison you can make, in addition to the Manufacturers Hanover, was that the exchange

subjected Jim and Marjorie to searching inquiries about their financial background. Even the most cursory examination would have shown in the degenture exchange situation that there was no authority for the act that took place.

A normal review would have examined both substantive and procedural steps as a very minimum to find out if the trust was authorized to make the investment in the E debenture.

If the exchange had taken just those minimum steps, they would have stopped this fraud in its tracks.

They say they relied on Lybrand. Well, then Lybrand was its agent, the agent of the New York Stock Exchange and if the agent failed the exchange is still responsible. That's where the buck stops.

Now, we come to January 1969 with all the information we talked about yesterday, all the exhibits, all the testimony. And what happens? On January 9th Mr. Schuette, the coordinator in charge, writes a memo that says the company has a violation. McKay has called him, it's going to be a violation shown in the audit report. That's the situation, and the company is filing some documents for an additional $1 million in capital, and negotiating with an institution for further

subordinated funds.

On the 13th McKay and Schuette talked on the phone again, and McKay says the firm needs 1.7 million -- the dollars have gone up -- to being its ratio up to 2000 per cent, and 2.3 million to bring it down to what has been called throughout this trial the early warning level of 1500 per cent.

That wasn't the first time that the exchange had heard about this problem, if you will, this net capital violation. Mr. Schuette testified that some time before January 13 he learned from Mr. Carley, the examiner who was on the scene, that McDonnell & Company was in violation as of October 1968. That was at transcript page 856 in this trial.

Mr. Bishop had a different version. He testified that Mr. Schuette was wrong, that Mr. Carley never told Mr. Schuette what Mr. Schuette had testified. How did Mr. Bishop know? He just knew. Was there a memo that said something like that? No. If it wasn't in a memo,it just didn't happen. That seems to be the version that you can find the New York Stock Exchange would have you believe.

In Mr. Bishop's special world of public relations, things never happen if you don't want to

remember them. They asked Mr. Bishop if the exchange had done the right thing at a certain point. Of course, Mr. Bishop said. "We were perfect. Did everything just right." That's Mr. Bishop's point of view.

But no, they didn't ask Mr. Bishop's boss. That question wasn't asked of Mr. ARning. Mr. Arning was the man who testified that all computer conversions at McDonnell & Company were disastrous. They didn't ask the coordinator in charge, Mr. Schuette.

He recomended reimposing restrictions back in late 1968. Didn't ask him whether things were done perfectly.

MR. BROOKS: I am going to object to these questions that were not asked on the ground that Mr. Beebe objected to the same line yesterday in my argument. He was free to ask these questions if he wanted them asked.

MR. BEEBE: These questions were not objected to and I think it's a perfectly legitimate line of argument.

THE COURT: Ladies and gentlemen, I should instruct you you may draw such inferences from the testimony or lack of it as the case may be in this case.

Go ahead.

MR. BEEBE: I would ask you then on the same line, whether the lack of testimony by Mr. McElroy, Mr. Newman, Mr. Spies, and Mr. Greves, along those lines, leads you to any inference about what did and didn't happen.

McDonnell & Company, as you heard from the summation yesterday, was one of the 6 per cent, you may find this also from the Exhibit 86, one of the 6 per cent of the companies where the New York Stock Exchange failed to do its job.

Now, you have here in January 1969 a list of problems that were done to the exchange at a time when the question is, what was their response. Even more pointedly than what was their response earlier. Net capital violation. 3992 per cent. Remember what Congress mandated? 2000 per cent; absolute limit.

Serious record keeping deficiencies, violations of Rule 440. They later found out the charging memo but it was in existence in late 1969 and early 1969, in January.

Failure to supervise and control the company, violation of Rule 342. Delays in filing the audits, 1967 and '68. Violation of Rule 417. Loss of the key executives plus the man who was going to replace

Sean McDonnell.

Withdrawal of two partners taking with them $400,000 of the firm's capital. That was Mr. Schuette's memo. January 13, Exhibit 37.

Now, the fact that the company was operating on voluntary restrictions also, of course, was known to the exchange later in January. You can find from the testimony, I submit, that that was never communicated to our clients, and the losses that the company apparently suffered in the fourth quarter, what did the exchange -- did the exchange learn aboutthem? Did the exchange have men on the scene to find those things out? According to the exhibits, 16 and 98, the loss before taxes was over $1,100,000 in the fourth quarter of 1968 and that is contrasted to a profit in the first eight months of $1,595,000. Quite a turnaround.

You may find under the law also that the exchange had full knowledge of the unclean opinion letter issued by Lybrand on January 15.

You can find, as his Honor will explain to you under the law that each of these facts constituted facts that required some response. We will get, as you know already a lot of what the response was and we'll go into a little more later. You may ask yourselves,

was the response measured, adequate, proper?

Much has been made about the family connection, and the supposed importance of the family relationships here. You ask yourselves, the unfortunate questions, can a son defraud a mother? Can a brother fool a sister? Can one brother wrong another brother? There are many different kinds of families just as there are many different kinds of people. Most people are honest, one hopes. Not all.

Most grown men would protect their mothers, not all. Some families are close, some divided,and this one the McDonnells was very large, as you can see from the evidence, very spread out. More than twice as big as this jury.

Murray was years older than Marjorie. You heard testimony that they grew up on different floors. The only evidence brought out before this jury that Murray McDonnell didn't tell his mother the true facts, that he and his underling Olney withheld the matreially adverse information from his sister, and that Jim McDonnell was denied the current bad news about the company.

There is no blood exception, no special rule that says families are entitled to less protection. A

sister is not an insider. A mother is not a partner. No inference can be drawn from common sense that one brother will tell another brother the truth. Knowledge must be proved from the facts. The family relationship is not a defense.

You may consider not only the evidence but your own common sense, and your day to day experiences. Do family members know each other's business? You recall that in cross-examining Mr. Olney, there was a long list of sons and daughters of Anna McDonnell and Mr. Olney admitted that he hadn't contacted all of the ones who seemed to have some business savvy or who didn't have any money, or whose husbands were knowlegeable in high finance.

Surprisingly, Mr. Olney was not instructed to call those people. Is this a family firm, where the family gets together and everybody bails this company out no matter how bad things are? Where is the close-knit group, all supporting this business that you have heard argued?

There was laughter in the courtroom when these questions were asked because it became obvious that it's not a family firm. It's a firm, you can find from the evidence, of Murray, perhaps Morgan,

Sean when he was alive, not our clients. They weren't insiders. They weren't officers. They weren't directors. At the time they were asked to come in they weren't shareholders.

The argument cannot and should not be made that the plaintiffs here are entitled to any different protection under the securities laws than anyone else.

Now, what were these people told when they made their investments? What were the facts that were communicated from one place to another place? Mrs. McDonnell's testimony was alluded to in the summation and you heard it read here, and it's undisputed. It was that Murray called her and asked for all her stocks which were lying in her safe deposit box where they were safe.

Here is what she testified, just as you heard it read earlier, starting at -- well, it's in the transcript, and I am sure you remember what was said:

"Q Did you ask any questions about why your money was needed now for the firm?

"A Actually, no.

"Q Do you recall any explanation being given by Murray or anyone else as to why your money was being requested?

"A I think I mentioned it earlier, expansion.

"Q Anything else?

"A No."

That's the end of that quotation. And then I asked to have her testimony read as to what she meant by risks, the risk she was entering into, and here's what she said, because she was asked by Mr. Brooks when he examined her up in her apartment at this deposition a few yearsago these questions and here are the answers:

"Q Was it a meeting between you two?

"A No, a telephone conversation.

"Q Do you recall whether he told you that McDonnell had any problems at that time?

"A I don't really recall.

"Q Do you recall whether he told you that McDonnell was in violation of the New York Stock Exchange capital rule at that time?

"A No.

"Q He did not tell you that?

"A (Shaking her head no.)

"Q Did he tell you that the firm had record keeping problems?

"A Not at that time.

"Q Did he tell you anything about the condition of McDonnell?

"A Not that I recall."

Referring to Jim's letter when she was interrogated, and that was the letter where he advised against this kind of investment in general, she said, and the question was:

"Q The third paragraph of the letter says in part 'Subordinating your account subjects you to these risks.'

"The question is, were you aware of any unnecessary risks in subordinating your account at this time?

"A I wouldn't use the word unnecessary. There were risks.

"Q Will you tell me what they were?

"A The risk I might lose all my money.

"Q Were they explained to you by anyone?

"A I knew enough.

"Q Were there any more risks in 1969 than there were in 1962 or 1965?

"A Wouldn't you know that for yourself?

"Q The answer is yes?

"A Sure there were more risks.

"Q Can you tell me why the risk was greater at this time?

"A No, the risk was greater because I was giving everything I had.

"Q Were you aware of whether an investment in McDonnell in January of 1969 was any riskier than it was in 1962 or 1965?

"A Yes.

"Q Was it more risky in 1969?

"A Yes."

Then the next question: "Do you know why that was so?

"A Because it took everything I had."

What did Mrs. McDonnell know in January 1969? She testified that she knew things were worse than in 1962.

I submit to you, ladies and gentlemen of the jury, it's a far cry between knowing things are worse than being followed precisely what was wrong, how bad things were. All these facts that were known, including the losses, in 1969, January 1969. You can readily conclude she wasn't told any of that.

Under the federal securities law, as his Honor will charge you, it's materially adverse facts

that matter. That's what wasn't told to her.

Mrs. McDonnell knew there was a great risk involved in subordination. I submit to you, ladies and gentlemen of the jury, that as you recall from Mrs. McDonnell's testimony, the risks she referred to on interrogation by Mr. Brooks were the risks from subordinating all of her securities rather than the four securities that she had subordinated in 1962. They were in no way related to the severe record keeping and capital violation problems and self imposed restrictions and all the other things that were listed above that were true in 1969 in January, because she was not told.

You will notice that there is nothing in the record to refute her testimony. How much did she put in? Exhibit 10 provides the answer; $1,136,425 worth of securities on January 31 -- January 30, 1969.

You may also find from the evidence in this case that the value of her subordinated account as of October 31, 1968, and this is contained in that bulky Exhibit Z, which is the audit was $555,546; so the total in her account, if you add those two from different dates -- I am going to talk about that in a minute -- is $1,691,971.

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There is other information in the record here about how much her account was worth total on January 30, 1969. It's almost identical but it's a little smaller than the number I just gave you, slightly more favorable to the defendants if you will.

That is Exhibit 43A, which was McDonnell & Company's computation of the value of her account which was sent over to the exchange and stamped "Received" by them. It shows that her account was worth $1,645,961.

I should point out that this evidence that is now in the case is more complete than the chart that we had at the beginning, and it's the evidence that we are relying on. Those funds weren't for expansion. The evidence tells you that. They were desperately needed to save McDonnell & Company and protect the special trust fund of the New York Stock Exchange.

Mrs. Murphy, the other plaintiff, who you heard a lot about here, also received two phone calls at that time, and she was a little less -- just a little less naive than her mother according to the testimony, but unfortunately not much less.

When Richard Olney called her under Murray McDonnell's orders she asked Olney, "Dick, is there any

risk?"

And you recall both at the beginning and at the end of this trial she reaffirmed that Olney told her that they needed to borrow her account, and now I am quoting from her testimony way back in the beginning, "for a very short period of time for an underwriting."

And then, and I am still quoting, "I asked Rick whether there were any risks that I was taking and he guaranteed that there were no risks, that they owned two seats on the floor of the New York Stock Exchange, that they had a very valuable collection of paintings, furniture, and all of this would be sold to pay me back.

"And I said, 'Rick, you promise me there are no risks?' and he said 'I promise you there is no way you can lose your money.'"

Mr. Olney had other versions of that conversation. You have watched the witnesses and as in all cases it's up to you, the jury, to determine wher e the truth lies. Consider what Mr. Olney didn't say. Even his own version of the facts. He never told her about the net capital violation. Neither he nor anyone else, according to this record, bothered to let her know that the company had received the unclean

statement from Lybrand.

No one told him that the company was losing money in the last four months of 1968, was up to its ears in horrendous paperwork problems caused by the failure of the computer conversion or any of the other terrible problems befoer she was asked to put her stock up.

Both of these women had been lulled into a sense of security. They had loaned securities, their stocks, to McDonnell befoer in the past on a temporary basis and each of them had received small interest payments and they had gotten their securities back. Thus he had no reason to suspect at that point that everything was very different or very wrong this time around.

Each of them received a little advice from a man, it happens, in Mrs. McDonnell's case her son James told her she shouldn't make subordinated loans but James didn't know, at least according to the evidence here, that any particular trouble existed in McDonnell at that time. In fact, he later put some money in himself.

As he testified, he was against subordination in general because, as he put it, it was a no-no. He just disapproved of the idea of subordinations.

He had no reason to suspect that the New York Stock Exchange and McDonnell were concealing and holding back a long list of terrible developments in the company.

You were also asked to consider whether Mr. Olney had a bias, or whether he was just testifying here out of the goodness of his heart and would be as likely to be honest as a completely innocent bystander. Well, he is an investment adviser, he testified on the stand.

I just ask you, could he confess that he had defrauded a customer sitting here under oath? Wouldn't that be the end of his career? He had the strongest reasons possible, as he sat up here, to continue the coverup.

There has also been some talk about Marjorie having filled in some handwriting, giving some personal background, and I guess the argument is that if she filled that in at 6:30 in the morning she must have looked at the documents; but the testimony that Marjorie gave was that she didn't remember when she received that, and that she had to have talked to her husband before filling in one particular item having to do with a bank loan.

So, from her own testimony I think you can fairly conclude that she signed at 6:30 what was put in front of her to sign, and later on filled in this personal data and mailed it in, somehow got it back to the company, just as she said. No great mystery to that.

You might also consider Jim's conduct in terms of his veracity. As soon as he learned what the problems were, he took immediate and decisive steps to try and repair the damage and he is still here today trying to do it. Paul McDonald vouched for him.

How much did Mrs. Murphy lose? Well, there may have been some confusion, but that's been put to rest. Exhibit 99, which was introduced through Mr. Bishop, was a letter to Mr. Bishop dated February 11, 1969, shows the value of her securities to be at that time, end of January, $342,000, and it deducts the debit balance that is on the books against her account, roughly $59,000, so that the net loss to Mrs. Murphy was $282,623. That's in Exhibit 99.

Just to round out this area, let's talk about Jim's investment. The only difference between what he knew and what Mrs. McDonnell knew and what Mrs. Murphy knew at the end of January was that more time had passed. He came in April or May.

You can infer from the testimony and exhibits that the problems had worsened, the exchange was still not putting on restrictions. He received some information about a letter from McKay, and he also received at one point that little statement, I think it's Exhibit J, which was a summary of what Lybrand, a revised summary of what Lybrand had found.

There was some big to-do about when he had received it. He never denied he received it at some point. He just didn't know exactly when. It's not listed in the materials that McKay sent over.

Now, Exhibit 16, which was some of the materials he received from McKay, contained what's called in Exhibit C, which is a profit and loss statement of McDonnell & Company -- this is what McKay was sending over in April.

This only goes through August 30 and it shows these terrific profits, $1,595,000 before taxes for the first eight months. McDonnell knew a lot more at that point about what their situation was, that sure wasn't the latest information.

Even that little Exhibit J was only up to October 31, and you may fairly conclude that McDonnell knew a lot more about what their losses were at the end

of the year by then, and didn't bring that to James' attention.

I need hardly say that the other information about the violations, about the fact they were on voluntary restrictions even at the end of January, whatever those slaps on the wrist were worth.

The record keeping, the withdrawal of the partners with $400,000, all the matters we have gone over so many times and were so painful to the company, there is no evidence that that was communicated to him and he denies it.

As far as Jim knew the company was making $1,500,000 before taxes or at that rate, as in the last eight months -- first eight months of 1968.

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Let's just focus for a minute on Exhibit J. It was the one that was passed out to the jury, that little piece of paper. Compare that with Exhibit Z. Exhibit Z is the big audit. Exhibit Z had the unclean Lybrand letterhead, Exhibit 89.

Exhibit J, unless you reach some other determination --

MR. BROOKS: Your Honor, I am going to object. I don't think the opinion in Exhibit J is any different than the opinion on Exhibit J is any different than the opinion on Exhibit Z. Counsel has said it is different.

MR. BEEBE: Why don't I read it to them?

THE COURT: Well, isn't this something that is a matter of fact, and do we have to spend ten minutes this morning reading the opinions?

MR. BEEBE: It is very short.

This is Exhibit Z-- may I?

THE COURT: All right.

MR. BEEBE: After referring to the passage in the audit itself on securities differences relative to securities whose ownership or physical location could not be ascertained, and reference to Note 1 -- I am here quoting -- "With respect to the corporation's net capital as defined by the regulations of the New York Stock Exchange",

and after talking about those two references, the last paragraph reads: "Except for the effect of the resolution of the matters referred to in the preceding paragraph, the accompanying answers are in the form required and in conformity with general accounting principles," and so on.

Exhibit J. Very short. No exceptions, no references.

"We have examined the statement of financial condition of McDonnell & Company, Incorporated as of October 31, 1968. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances."

The last paragraph, one sentence:

"In our opinion the above statement of financial condition presents fairly the financial position of McDonnell & Company, Incorporated on October 31, 1968, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

MR. BROOKS: Your Honor, I object again unless this includes the reading of the notes, which are part of the opinion.

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THE COURT: They are not part of the text?

MR. BEEBE: They are not part of the text.

The note which I believe is being wrongly referred to at this point says dated -- it doesn't say dated; that is what it means -- "New York, January 12, 1969."

And then "(except as to the note to the statement of financial condition with respect to which the date is February 6, 1969.)"

MR. BROOKS: Aren't we entitled to a reading of the note if he is reading the opinion?

MR. BEEBE: May I proceed, your Honor?

THE COURT: Yes, let's go ahead.

MR. BEEBE: Ladies and gentlemen, you are entitled to bring these back in the jury room and call for them and examine them yourselves. I believe you may conclude after examining them in your own judgment that they are not the same.

There was testimony that Exhibit Z was not a clean letter because of the references and the exception. There was testimony that Exhibit J was a clean letter.

On top of everything else, Exhibit J makes no reference to the fact that Exhibit Z had issued, an unclean letter.

The notes that were referred to there, you may

reach your own conclusions as to how much and how little was disclosed in them about the events that occurred in January.

There is a letter in Exhibit J by the chairman of the board of the company to the clients of the company which you may also read and conclude that it says to the effect that things are getting better, and particularly that the computer conversion seems to be in good shape.

What it doesn't say is that the computer conversion had not worked since July 4, 1968, and what the effects of its continued failure were on the company. That's not in here. There is nothing in here about a contingent liability of twenty to two hundred million dollars.

THE COURT: I do not find that appropriate, Mr. Beebe. This is the October, 1968, statement disseminated in February of 1968, and Mr. McDonald's statements were at best made late in 1969.

MR. BEEBE: As I remember Mr. McDonald's statemnt, your Honor, it was in November, 1968, that this contingent liability arose, not that Mr. McDonald discovered it in the summer--

THE COURT: There are two periods the second of which, if I recall, was in the spring of 1969, and there was the two of them together that caused this to come to pass. You

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cannot separate it and say this had come to pass and was in existence at the time that statement was prepared.

MR. BEEBE: Well, I have a recollection --

THE COURT: Remember, ladies and gentlemen, whatever counsel or I say about the facts in this case, it is your recollection of the evidence that governs; it is your determination of the facts that governs, and if there is any variance between your recollection and ours, it's yours that governs, and you may have the testimony read back if there is any question in your minds as to what it was. And you may look at the exhibits if you have any question as to what an exhibit contains.

Go ahead.

MR. BEEBE: Now, moving on from what Mr. McDonnell had testified -- that is in the transcript and it is available -- we come now to the question of how much James McDonnell put in, and the answer from the exhibits and the testimony you may determine was $20,718.

You may also conclude from among other things, Mr. Stargatt's testimony, that that is now worthless.

The exchange argues that in January, 1969, by pulling in our client's funds without telling them about the underlying problems, it was dealing first with the capital deficit and then it was going to deal with the

operations problems.

The federal securities statutes and the exchange's rules, as his Honor will charge you, required the exchange to enforce all the rules.

Let's look at what the exchange did in the record keeping and supervision areas, freighted as they were with all this knowledge about what was going on at the McDonnell Company.

We have seen that they did nothing to reimpose the April, 1968, restrictions throughout the rest of 1968, and nothing short of restrictions such as fines or censures or even disciplinary proceedings were begun by the exchange. They didn't even send them a letter. They didn't tell McDonnell & Company "Shape or or else." They didn't even pick up the phone, according to their memos, and say "Do something."

In January, 1969, when these operational problems were so bad that they pushed the firm over the net capital limit the exchange still didn't do anything. A few quick phone calls from the company to our clients, that is, Mr. McDonald and Mrs. Murphy, at the end of January, a hurried early morning visit to Mrs. Murphy's home, and our clients were separated from their funds. But the assets didn't solve a darn thing as far as McDonnell & Company's

operations were concerned. And we really could question also from the evidence whether they solved the capital problems themselves.

Examine, if you will, the exchange's internal computations, the net capital ratio from the beginning of this sordid affair to the end, and here is what you find:

I submit that you find a continuous list of net capital ratios starting on October 30, 1968, the as of date, right on showing the ratio over 2,000 per cent, both before and after our people came in.

The first ratio, in fact, which you might want to look at was as of June, 1968, which was before this time, and it is 1873 per cent. That's over this early warning level they are talking about.

Now, October 30th: The first time it comes in is in this phone call from McKay on January 13th. He says "We are going to be 1,700,000 over the 2,000 limit," not the early warning limit, the congressional limit, over the limit, a million-seven.

The same date, October 31, 1968, the exchange then analyzes the figures, and what do they come up with? 3,992 per cent.

If you want to take a different figure, they also put 2,717 per cent, but the exchange had to give McDonnell

a special charge to get down to that low figure.

These are Exhibits AA, 39 to 74.

Lybrand comes in and despite that there was some testimony that Lybrand never does ratios, it did. One of the exhibits has it, Exhibit 20, and as of the same as of date, 3,027 per cent.

In April after a thorough analysis by the exchange internally the figures are still 3,565 per cent, or 2,512 per cent. And you can also find that in the charging memo where they took the lowest figure possible, it's still 2,512 per cent.

The memo is talking as of October 30, 1968.

Let's go to January 30, 1969.

You can say, "Mr. Beebe, you are not doing it right because you used that earlier figure. Later on they got out clients' capital and everything was hunky dory.

Let's look at their own figures. The exchange analysis, April, 1969, all of the exchange analyses -- remember they had a whole series of numbers -- under every conceivable alternative method of over 2,000 per cent. Those are Exhibits 23B and 25.

The ratios are 3,825 per cent, and this was the second one that one of the witnesses testified he never heard of one so high; 5,525 per cent and 3,920 per cent.

s1h9

Things weren't getting better. I mean, that's an understatement. And that's after, after counting our clients' money. It doesn't go down; it goes up.

March 27th the exchange says - as of March 27th it does another analysis. If you follow me, I am talking about October 30th, January 30th, and now we get down to March 27th, another exchange analysis. The amounts are either 2,920 per cent, 2,629 per cent, or 2,522 per cent. That's Exhibit 23B.

When you get to August, 1969 -- and I am jumping down to the end of that summer -- and the exchange's own exhibit, EEE, shows an astronomical figure, and it's there. Look at EEE as of August 31st, 20,329 per cent.

Even take that same exhibit -- there is always an alternate number when the exchange does it -- and the alternate numbers are on an immensely scaled down basis, and, remember, I hate to keep reminding you about 2,000 is the limit, the alternate number, 5,278 per cent.

This is why I talk about Alice in Wonderland.

Now, what do you conclude from this? A fair inference, a fair conclusion is that the bringing in of our clients' funds was merely a cosmetic; they covered up the fundamental record keeping problems. They painted over them. They put on a whitewash. The fundamental problems

slh10

that undermined the firm's net capital position wer left untouched. Nothing meaningful was done by the exchange at that time or earlier to correct these record keeping and operation problems.

These problems were like, if you will, a hungry tiger eating away at the firm's capital, a hungry tiger crouched in the background waiting to devour any new assets that came by, anything thrown in its way.

On January 29th the exchange didn't order McDonnell to tame or cage this hungry tiger. Instead, it ordered McDonnell to feed it, get more capital.

You can find that the meal that the tiger was going to feed upon and did was our clients' assets.

Now, ladies and gentlemen, you may say: Slow down. slow down, Mr. Beebe, you forgot something. You forgot those voluntary restrictions put on on January 28th.

Doesn't that have any meaning? Maybe that solved the whole problem. Wasn't the exchange doing something there?

Well, of course, the exchange wasn't. McDonnell wrote out some pieces of paper and made some more promises, but there is a more important thing you might consider, and that was that McDonnell & Company had already been on voluntary restrictions. Remember after the April restrictions,

slh 11

1968, they went supposedly although there is no writing to show it, on voluntary restrictions in July, 1968.

After that Mr. Schuette said in his testimony "I knew they were on voluntary restrictions but I still recommended late in 1968 that the exchange impose real restrictions."

Nothing happened.

What happens? In January, more voluntary restrictions, a slap on the wrist; no meaning, no meaning in terms of what the exchange had available to it to impose, fines, censures, disciplinary proceedings, dozens of things at their command, weapons in their arsenal to do something. None of it was pulled out.

So instead what did they get? A slap on the wrist, at best. It wasn't even a slap administered by the exchange.

You can also look at what happened and decide for yourself whether that was even approaching adequacy.

Your Honor, would this be an appropriate moment to take a minute, or shall I forge ahead?

THE COURT: What have you got, another hour and half to go?

MR. BEEBE: At the most.

THE COURT: I think you might as well go ahead for a while.

s1h12

MR. BEEBE: Fine.

Now, with regard to these voluntary restrictions, it's another way of saying that the exchange was trying to pass the buck and say, "McDonnell & Company, you do it, we are not going to do it."

Well, I submit that is the kind of buck you can't pass. It is the exchange's responsibility to do something. You can't look over to the other guy and say, "You do it, and if you don't do a good job it is not my fault."

There is another point to be made here: our clients, as his Honor will charge you, were entitled to rely on the fact that the exchange was taking appropriate measures to correct the problems. That's part of the exchange's undertaking. "We will do this." They say they will. That is, when they are enforcing the rules they will do it.

Our clients didn't have any reason to believe they weren't enforcing the rules through any testimony that has come in here.

How long is it fair for the exchange to rely on McDonnell & Company to solve its own problems? And I am not starting in January. I think back in April, in the summer of 1969 when the exchange did just that. They

slh13

took off these April restrictions. April restrictions, the now you see them, now you don't restrictions, and then in July, 1968, voluntary restrictions come down. Schuetto recommends the imposition of real restrictions. All these capital problems, arbitrage problems. How long can the exchange stand back and say we are not going to do anything; we don't have to do anything. Let it go. Let it go.

Our clients couldrely on the fact that the exchange was doing its job.

Well, we get into the area of motivation, and I think the eay you might want to consider looking at this is that the exchange wears two hats. It uses our clients' money, you may say, and once it had our clients' money in the house, give McDonnell & Company a little time to play around with our clients' money and maybe solve the problems and correct the situation.

Well, you may infer on the contrary from the evidence that what happened was they were using the money, the exchange was using money to put off the fateful day when the trust fund would be called upon to pay those public customers and the claims that would come rolling into the trust fund.

Under one hat the exchange is a self-interested trade association of member firms out to make money. It is

s1h14

not ashamed of that. That's what it is there for.

The other hat is a self-regulating hat which the exchange took upon itself to avoid SEC supervision and said it would enforce; it said it would enforce all those rules --

THE COURT: Mr. Beebe, I am not sure that that last statement as a matter of law is warranted, that they took it on for a particular purpose. They were regulated under an act of Congress and charged with that act of Congress as to the nature of the regulation.

MR. BEEBE: Yes, sir. I was alluding to Professor Ratner's testimony.

THE COURT: All right, I understand the source. Go ahead. We are talking here, though, in 1969. It was at that point a statutory scheme.

Go ahead.

MR. BEEBE: I will say the two hats again. The one is the self-interested trade association of businessmen gathered together to buy and sell stocks and make money, and the other, self-regulation, they are going to regulate themselves under the statutory scheme.

Now, you can find that it is much more comfortable to regulate yourself in good times than in bad times.

You can find that the temptations in that situation

s1h15

in 1968 and 1969 led the exchange astray, tho time when its own pocketbook was in jeopardy.

The testimony in the exhibits make it clear that the exchange set up a special trust fund where claims could be made by customers when a company went under.

It was in the exchange's own interest, you may find, to pay those claims through the special trust fund. Much to do about it being a discretionary trust fund, you may conclude that it was in their own self-interest to have the trust fund pay the claims rather than have the claims come directly against the exchange.

The special trust fund didn't cover subordinated lenders. I hops you have not been confused aboutthat. Our clients are not under the special trust fund. That's why they are here.

McDonnell & Company, according to the evidence, had 26 branches and approximately 50,000 customers in January, 1969. It dwindled down to three branches by the time it closed on March 13, 1970.

Still, when the claims against the special trust fund came in after McDonnell was closed down, the testimony has been that it was seven, eight or nine million dollars. That is with only three branches.

You may infer that the claims would have been a

lot higher in January, 1969, if McDonnell had been restricted and shut down at that point, or around that point when it had 50,000 customers out there.

A fair inference would be -- well, you may reach your own fair conclusions as to how much higher it would be than the eight or nine million dollars that were there when only three branches were involved.

The claims I believe you may conclude, in January, 1969, from the collapse of this phone company in the middle of the paper crunch would have been in many, many millions of dollars.

What happened in January, 1969? You may conclude that the exchange quietly took off its self-regulatory hat, put it in a closet, closed the closet door, put on its self-interest hat and operated from its own self-interest, not enforcing its regulatory duties, because it wasn't in its interest to do so.

When you look at the evidence you may see a pattern emerging, a pattern of special interpretations, peculiar unexplained failures to act when there was so much information in the exchange's possession.

Then think about the conflict of interest with the two hats. If they put McDonnell & Company out of business in a matter of hours, or, at most, a week, as Mr.

Arning said, the most he ever heard anyone with a net capital violation being allowed to stay around; if it notified, that is, if the exchange warned potential investors about the gravity of the situation and thus scared them off, if it failed to rescue the company by whatever means possible, the trust fund would pay, and pay very dearly, many, many millions of dollars. The members of the exchange would be hit right where it hurts them, in their monetary interest.

That is why you may conclude the exchange quietly, very, very quietly started acting in its own self-interest and didn't enforce the rules.

Arning told the truth in one respect on the stand when he was asked questions about what the exchange would do if a company that was large was going to be put out of business following the self-regulatory function that it had to, that the exchange had to furnish and provide, and here's what he said:

"The exchange never dreamed of suspending anyone if the trust fund couldn't cover them."

Think about that in comparison with the size of the McDonnell Company in January and how much of a claim that would have made against the trust fund.

And think to yourself, what was it that motivated the exchange to act? When push came to shove, the exchange

ignored those duties, those statutory duties, those moral duties, and it thought only of itself. It let the capital investors, people like our clients, be damned. That is what the exchange did; that is what the exchange thought. That is what motivated them to act.

The exchange piously announced to the world later, much later, that it had been acting for the public good.

Now, a jury could find that what it really had in mind, uppermost, when it was acting, was its own good, its own money, its own pocketbook.

It was untrue, unreal, it was an Alice In Wonderland world that the exchange lived in, where words were deemed to mean things, and that's what the exchange wanted them to mean.

Violations become problems; self-protection, self interest become self-regulation. An excuse, any excuse, was allowable, was permissible in order to prevent the house of cards coming down, in order to avoid the threat to their monetary interests. If it came to cheating a mother, a brother taking from a sister, one brother misleading another one, so be it.

As long as this venerable institution the New York Stock Exchange survived,it didn't matter if there was a little abnormal application of the rules. If the exchange was enforcing the rules at that time, why did it reverse them especially for McDonnell & Company and ignore what each ofits own examiners and the coordinators who testified here advised them to do.

Why were the special interpretations made? There are a number of points in that area I want to cover. Maybe this is as good a time as any --

THE COURT: All right, we'll take our mid-morning recess, ladies and gentlemen.

(The jury left the courtroom)

(At the side bar)

MR. BROOKS: I observed during my presentation, and I have this morning, Mr. Beebe has, that juror No. 6 is a sleeper. I thought you might want to observe that and consider if anything should be done about it.

THE COURT: Very well.

MR. BEEBE: I could raise my voice louder, but I have observed that during the trial she's been quite attentive.

(Recess)

MR. BEEBE: May I proceed, your Honor?

THE COURT: Yes.

MR. BEEBE: Now, the pending question was, what were the special interpretations. You may recall that there came a time when lettered stock, this legended stock, suddenly grew dollar signs despite the express language of Rule 325, which is before you, and the testimony of innumerable witnesses that they never heard of it being used as good capital.

You have the strange failures to take strong measures in 1968, the arbitrage ruling and the failure to act quickly even when McDonnell was way over the net capital ratio for a long period of time.

Mr. Arning testified in no uncertain terms, and that was Mr. Bishop's boss, remember, that in usual application of the rule, a company over the net capital limit would be put out of business in a matter of hours. He had never heard of one lasting more than a week. What happened here?

You may infer from the evidence, I submit, that what happened here was a non-normal application of the rules starting back in 1968 and continuing throughout this sorry affair. The evidence shows that every time McDonnell asked for a special ruling to avoid a net capital violation the exchange examiners and coordinators, the Mr. Schuettes of the world, refused, and the higher-ups simply bent the rules, if I may be so polite.

You have a tax claim becoming good capital even though nobody pretended that Andover, Massachusetts or anybody else said it was going to be paid in 30 days. Scheinman, Hochstein signed a vague letter of intent. That is Exhibit 59. You may reach your own conclusions as to how binding that was. It said they were talking about subordinating $650,000, "if the terms were acceptable to Scheinman."

You may conclude that that was suddenly given credit as good capital even though the subordination

didn't take place, the sale collapsed, and Scheinman found out, Mr. Scheinman found out on July 1, 1969, that McDonnell & Company would run out of money if an audit was taken before the audit could be completed.

We have a press release here, press release out of the blue on August 1, 1969, is sent over to the stock exchange, has Mr. Stock's scroll on it,and Mr. Bishop apparently saw it, his initials are on there, saying that or announcing to the world that there are three to ten million dollars of new capital coming into McDonnell & Company and everything is going to be honky-dory.

That is Exhibit 60A, when it went over to the stock exchange. It's Exhibit 61 when the New York Times carried it the next day. The report says that the exchange knows all about these developments, but the evidence is just the contrary.

The report proves to be false, you may conclude from listening to the testimony, the new money didn't come in. The management was changing, the situation was awful, but the exchange sat on its hands. No retraction, no corrections, no action to enforce Rule 325 that had any teeth in it, nothing definitive and final. Why not?

And what rule, we were asked earlier, what rule was the exchange supposed to enforce about this press release if it was false?

Well, the very section 6 agreement under which the exchange was operating requires it to enforce the Federal Securities Exchange Act and the Federal Securities Exchange Act prohibits false press releases.

While all the exhibits and testimony before you --

MR. BROOKS: I object to that, your Honor. It's a misstatement of the law. The law is for your Honor as to what the Securities and Exchange Act prohibits. It certainly doesn't mention false --

MR. BEEBE: I believe as to Texas Gulf Sulphur and a number of other cases, that is exactly what the situation is.

THE COURT: It's a request as to whom?

MR. BROOKS: I suggest that it only prohibits something in connection with purchase and sale of securities, your Honor, and Mr. Beebe's statement didn't assume that fact, and the evidence doesn't show it.

MR. BEEBE: I think --

THE COURT: I will charge on the law, ladies

and gentlemen, that is applicable to this case.

Go ahead, Mr. Beebe.

MR. BEEBE: Well, we come to three very important internal memoranda or documents by the New York Stock Exchange, and I was going to say that all the exhibits and all the testimony are important, but I invite your attention particularly to these three. They look backward over the events of 1968 and 1969.

The first one in time is Mr. Schuttes's chronology of March 28, 1969, Exhibit 46, which covers everything from the "now you see them, now you don't" restrictions of April 1968 through each of the steps in the deteriorating situation of the firm in that year, both in operations and capital problems, and they are all spelled out in detail. It's a very convenient listing.

The second one, yesterday, came out, was a document that apparently was withheld before, the exchange's own report dated October 1969 right on McDonnell & Company. That's the subject of the report. It's Exhibit 111.

In that report, the exchange laid it all out; the basic problem. It starts off -- this apparently has SOQ up in the corner -- but "The basic problem," it says, "decling volume and substantial expenses from a

new computer system which did not work caused operating losses which resulted in capital violation."

The computer system failure, that's what caused the operating losses, and that's what resulted in capital violations.

Now, you have seen from the testimony that started in the summer of 1968. It was promised for the July 4th weekend of that year. The report says exactly what we submit all the evidence shows to be, that the operating problems, these unresolved operating problems which I called the hungry tiger, you can call whatever you like, they led to the capital violations. They led directly to the capital problems, and there is a direct connection between the two. If you don't solve the operating problems, you are going to continue to have capital problems. It's not very difficult.

This report went on, "During 1968," it says, "During 1968 the corporation incurred additional expenses of some $1 million incidental to the undertaking of the conversion to the system with resultant impact on earnings and hence on capital."

Well, that can be translated by yourselves to the conclusion that they lost money, it's as short and simple as that, becuase of hte operating problems, a

direct connection.

Page 3 of the report says that the problems started with the death of Sean McDonnell in mid-1968. That's exactly what we are saying, that the problems starting with operational problems led to the taking of our client's assets at the end of January and the exchange failed to act on the basic problems to enforce its rules to correct the situation and to do something about that deadly tiger eating away at the capital; eating away at the company's assets. That's the violation of the exchange's duty.

Now, you might say maybe that's something that the exchange can do, can suspend enforcement of the rules. But it didn't tell our people that they were still coming in. It's got to be a quid pro quo. If you do something you have got to enforce the rules when you take in our money. That's only fair. Or if you don't, at least tell us about it.

The third page or exhibit is the special membership bulletin by President Haack of the New York Stock Exchange. There was much questioning of Mr. Bishop by his counsel, much testimony by Mr. Bishop trying to explainaway the bulletin, but there is no denying what it says. I am quoting from some passages

and the whole thing is Exhibit 86. You can call for the whole thing.

"The past three years" -- that is 1967 to 1970 -- "have been a period of perpetual -- have been a period of perpetual crisis for the securities industry. What is not generally appreciated is the severity of the crisis or the monumental pressures placed on the exchange as a self-regulatory organization.

"The paperwork crunch of 1968-1969" -- '68 and '69 again -- "and the severe profit squeeze that followed required the exchange to intervene actively at one time or another in the affairs of 196 member firms."

Mr. Arning testified, you may recall, that McDonnell was one of those firms.

"Obviously the failure" -- this is quoting again -- "Obviously the failure of a substantial number of these firms would not only affect the financial well being of other member organizations in the exchange but also the strength and liquidity of financial markets throughout the United States and abroad."

You may read that same passage and translate it as follows: It's just another way of saying that the exchange put on its self-interest hat and decided not to regulate when that regulation would affect the financial

well being of the other member firms. When the stakes got high, the exchange quietly stopped enforcing the rules.

As you know from the evidence and as this memo goes on to concede, the stakes were very high in McDonnell's case in January 1969 and before. We submit that is why the exchange stopped enforcing the rules but didn't tell our clients. That's why the exchange had to keep the true condition from the people who were going to make the investment because otherwise they wouldn't make the investment.

"What precipitated" -- now I am quoting again -- "What precipitated" -- that is, what caused -- "this three-year crisis period was the fact that in late 1967 and in 1968 the most active securities market in history overwhelmed the industry's paperwork processing capacity. From April-July 1968 one million shares traded on the exchange, more than the total volume of as recent a year as 1962."

Does that sound like a familiar period of time April to July 1968? You remember those, now-you-see-them, now-you-don't restrictions? They were lifted in that period of time, and McDonnell & Company was allowed to go on its own merry way to disaster.

The exchange argues that it didn't make this non-normal application of the rules as to McDonnell & Company until very late in the day. We submit that you may find that the non-normal application started in 1968 before our prople were pulled on board.

The next paragraph in this memo states that "The height of the problem -- the height of the probler came in June 1968." A few member firms, according to this memorandum, were "allowed to continue in business despite the critical paperwork and capital problems."

Only three firms are mentioned. We can put aside Dempsey Tegler and Blair. The other is McDonnell & Company. They had a combined total of 165,000 customer accounts. McDonnell & Company is called a major firm; and Bishop conceded yesterday that it's fair to assume that the 165,000 figure represented the most accounts that the three firms had had. In other words, at the time that the problems were greatest, when McDonnell was full of customers, that's when this memo comes into operation.

From the evidence you have seen, that McDonnell & Company's paperwork and capital problems were critical and reached the point of violations by late 1968 and 1969, that's when they were full of customers, that's

when the threat to the special trust fund was the greatest. That's when a failure of McDonnell & Company would affect -- to use their own language -- "the financial well being of the other member organizations of the exchange."

We submit that you may find that was when the exchange put on its self-interest hat, put aside the regulatory hat, suspended enforcement of the rules, failed to tell our clients what they were getting into, took our client's money for the benefit of the other members of the stock exchange. That's where it went.

"Normal application of the rules would have meant possible losses for thousands of customers and potential chaos in the industry."

That's what they said. I have no doubt that's true. Thus you can find that the rules were not applied in the normal way in the case of McDonnell at that time. The industry was spared the claims of the thousands of McDonnell customers and the people who unknowingly helped to bail out the New York Stock Exchange, not McDonnell & Company, they bailed out the New York Stock Exchange, they were our clients. It was their money that was used.

You may find this memo very instructive reading in the jury room, and I invite your attention to the ending. It ends with the kind of public relations jargon apparently used by the exchange to gloss over what it had done:

"In summary" -- and I am quoting -- "during these three crises years the exchange has used a variety of new rules and surveillance methods" -- here comes the fancy language "tempered by practical business judgment of its staff and governing board in an attempt to cope with the problems."

You may translate that into very plain English. They let the business considerations, what was good for their pocketbooks, take the place of their regulatory duties. The regulatory hat was in the closet, the door was shut tight, and the self-interest monetary hat was firmly squeezed on their heads.

The exchange in this memo and elsewhere says that it's very interested in public confidence. That's what it was acting for. Well, that's the fancy way of saying, I submit, that the exchange was scared to death it was going to lose business. It was very worried people were no longer going to deal with it because it was in such a shaky condition. That's the

New York Stock Exchange nad its member firms in 1968 and 1969.

One way to keep people coming in to deal with the New York Stock Exchange, and that's customers and institutions who buy and sell stock there, is to pay them out of the trust fund if something goes wrong, so the exchange can say to the public "Don't worry, if anything goes wrong we'll cover you" and they will back it up with proof because they open the discretionary door, out comes the money from the trust fund.

But that's only as long as you have little companies that go under. LIttle baby ones, maybe a McDonnell even with three branches was still costing eight, nine million dollars. Once you have big ones, it's a lot more difficult to say "Don't worry, because we are going to cover you." It will cost you tens of millions of dollars in a case like McDonnell early in 1969.

So you can see a strong motivation in the exchange to cover up the problems in McDonnell: to buy time, to trim down the company's size, and when the money ends, and people could no longer be tricked out of their proceeds of their funds, that then it would be a much smaller drain on the trust fund and that's what happened here.

You can find that the exchange succeeded. It did trim down McDonnell's size. It did avoid the threat to the public confidence; and it did reduce the claims against the special trust fund, and the plaintiffs sitting right here weren't told anything about those plans. The exchange benefitted, they did not.

I am going to cover a few more points and then I will finish up. When Paul McDonnell went in and was being asked to make his investment in late 1968, he found the same record keeping problems which you have heard about here. He examined the latest financial statements, the cash flow projections, and made an analysis of the situation and said "No thanks."

You may infer from the evidence here that any reasonable investor who had been privy to that information would have said the same thing, "No thanks" when the full facts were revealed.

In the exchange's attempt to place the blame on someone else, they point out that the McDonnell Company had a chief executive officer, as did all companies. They say that he is the captain of a ship. That's how the testimony comes out.

Well, let's take that analogy the next step. The exchange then is the admiral of the fleet.

mbr

The buck still stops there.

Yesterday you heard some reading from Murray McDonnell's letter to the exchange. I am not going to read all those passages over again. You heard some argument that some ofthe material in here was supposedly self-serving.

Well, Murray wasn't called; and this was a letter they put in. Murray McDonnell, late 1970 looking back: "I respectfully submit that it's not fair to hold me personally culpable for the fact that management did not have reliable figures on which to maintain control for the ensuing several months after the controller died suddenly in November 1968. I respectfully submit it isn't fair to hold me personally culpable for the incompetence of Data Architects" -- that was the computer company -- "and their inability to complete the contracts they had with McDonnell to automate the back office procedures."

He also mentions McKenzie & Company, this national consultant firm, in 1968. And he says: "To the extent that the company allegedly operated in technical violation of some regulations there is clear reason why we continued to operate despite the violations. The department of member firms of the exchange repeatedly

urged the company to continue despite the alleged violations because the alternatives of suspension were inconceivable at that time."

That was Mr. Arning's testimony too. Violations now recited were known to the exchange while they were occurring and oral waivers were given by the department of member firms to continue while making best management efforts to correct the problem.

And this is all I submit consistent with exactly what you have seen here, the two groups of people testifying fromt he exchange, vast majority of the witnesses, the lower level group finding violations, demanding action, requesting the exchange to get moving, to enforce its rules. The higher level saying "We are going to make exceptions;" not enforcing rules and not telling our clients, nobody telling our clients.

"The position now taken by the department of member firms" -- this is quoting again, the last passage from his letter -- "The position now taken by the department of member firms," that is the New York Stock Exchange "argues that we should have ignored their oral directives and suggestions and that they were not personally authorized and responsible in so directing us. Repeatedly the management of McDonnell was advised by

officers and employees of the exchange that the regulations were subject to various interpretations under some of which we could not be considered in violation."

I submit, ladies and gentlemen, that on examining Exhibit WWW, which is all before you concerning Murray McDonnell's review of things, it's exactly consistent with what you have seen from the exchange's own testimony and the exchange's own witnesses that we called and the documents we put in.

There is another issue here about why the plaintiffs didn't withdraw their funds, this 100-day notice. You have heard from James McDonnell how much he wanted to get out. You have seen the letter he wrote, and Mrs. McDonnell also wrote on September 12 on behalf of the trust demanding return of the series B debenture. That is Exhibit 19.

You have heard Mrs. Murphy testify about trying to get out, and how she was told repeatedly that she had no choice, and Paul McDonald backed her up on that when he was on the stand.

You recall when he testified that he said there was no other way of interpreting what Mrs. Murphy was saying and that she was wanting her money back; and of course Rick Olney didn't return

the calls.

But you can also review for yourselves the subordination agreements which are Exhibits OO and Exhibit 3 and you may reach the conclusion that there was no way for them to withdraw their funds on a 100-day notice as a practical matter at that time of McDonnell & Company. That what they were told at that point is once they got in there was no way to get out again and that it was accurate under those agreements that they had been asked to sign.

You may find that the company could use such a notice as an excuse to go into bankruptcy or liquidation, which is just a fancy way of saying that if a major creditor comes in when a company is in financial trouble and wants to pull out his capital, the company goes under or can go under. It may have no choice. It may not have the capital to do it.

The 100 days notice gave the company plenty of time to do just that if it didn't have the capital and that's what they were told was the situation there: and you may see from the records that it's borne out by exactly what was reported.

These were people who were in the classic role of creditors of a troubledcompany. If they blow

the whistle the company goes under. If they stick around there is an outside chance that something might happen. They didn't have any choice. That's what the testimony was. You may find it supported by the evidence.

There is a fifth transaction here too; and that is the 797 shares of preferred stock that were in the company from Mr. McDonnell, Sr.'s trust, and that is also being pressed here.

You may find consistent with the charges from his Honor and the evidence in this case that the exchange's failure to regulate and provide a measure of response to the growing problems of McDonnell & Company led to the loss of that entire asset. It became worthless.

Now I have mentioned Humpty Dumpty. I have mentioned Alice In Wonderland and now I am going to mention Humpty Dumpty. Here's what it means when we talk about a Humpty Dumpty-Alice In Wonderland World.

What it means is that the New York Stock Exchange would have the jury believe things that are upside down, they are exactly backward from what your common sense will tell you. Humpty Dumpty said to Alice: "There's glory for you."

"I don't know what you mean by glory" Alice

said.

Humpty Dumpty smiled contemptuously. "Of course you don't know what I mean by blory till I tell you what I mean. I meant there is a nice knockdown argument for you."

"But glory doesn't mean a nice knockdown argument," Alice objected.

"When I use a word," Humpty Dumpty said in a rather scornful tone, "it means just what I choose it to mean, nothing more nor less."

"The question is," said Alice, "whether you can make words mean so many different things."

"The question is," said Humpty Dumpty, "which is to be master, that's all."

And that's what the stock exchange was doing. It was deeming things to be problems, not violations. It was deeming rules to be inoperable, not applicable, not applied to this situation. It had its own special magic rule where it could do anything it wanted.

To finish out this sad affair, we go to the fall of 1969, as you recall from the testimony, papers are pushed around, our clients are told they must take IOUs in exchange for the stock in their subordinated

accounts. The company is recapitalized. Our clients are told they can't withdraw their fund. Their stocks are sold. They are given these new pieces of paper. The exchange still doesn't find any violations, it still doesn't impose any meaningful rules on the enforcing the net capital or the operation rules of the company.

Delay has become routine, inaction, lack of action, is not the exception, it's the rule. The world is upside down at that point.

When the exchange later found that the violation in history started in 1967, talking about their charging memo, somehow in late 1969 the company is still in business. Will it ever be put out of business? Will the rules ever be enforced? Yes; yes.

A newspaper column comes along and blows the whistle. The exchange runs around, gets phone calls, writes memos, somebody is galvanized into action. The New York Stock Exchange finally, finally, finally, finally acts. Liquidates the company.

Now, at that point, ladies and gentlemen, we respectfully submit that you can use that as another measure of what the exchange should have done earlier because the facts were no different in any material sense than they had been earlier, except in one respect, one

respect, it was a much smaller company, so at that point there wasn't that much of a threat to the special trust fund.

You also heard testimony that Mr. Stargatt down in Delaware, after approving all the claims, and those are exhibits, 8, 11, 12 and 15, didn't pay anything.

He said that subordinated lenders or clients were highly unlikely to receive anything at all.

If they did receive something, if they moved up into the next category, he testified, if a judgment were entered against Mr. Stargatt's receivership, there may be a few pennies. That's what's down at McDonnell & Company. That's the situation there.

Now, if in this summation I have not referred to a particular document or I haven't mentioned a witness or I haven't -- if I have omitted anything that is on the fact before you, please don't neglect to give such document or testimony due consideration and consider all of it in reaching your determination.

His Honor will tell you all the evidence introduced before you is important. You have to consider it all.

You may find after considering every bit of it and all the summations and anything else you want to consider, including your own common sense, that the road we have traveled together does lead to the conclusion that the New York Stock Exchange and McDonnell & Company violated the provisions of the federal securities laws with respect to our clients.

The evidence we very respectfully submit, shows a failure to regulate, and shows a failure to tell the truth, shows that our clients were damaged as a result.

I thank you very much for your attention.

THE COURT: Ladies and gentlemen, we will take an early and a shorter luncheon recess than normal. I will see you at ten minutes of one. At that time I will charge you on the law.

(Luncheon recess)

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